TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935

No. 769

WILLARD M. EDWARDS, COLLECTOR OF INTERNAL REVENUE, PETITIONER

vs.

ARCHIBALD DOUGLAS, GEORGE NOTMAN, AND EDMUND COPPIN, AS EXECUTORS OF THE ESTATE OF JAMES DOUGLAS, DECEASED

ON [illegible] TO THE UNITED STATES [illegible] COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED [illegible]

CERTIORARI GRANTED [illegible]

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1924.

No. 524

WILLIAM H. EDWARDS, COLLECTOR OF INTERNAL REVENUE, PETITIONER

vs.

ARCHIBALD DOUGLAS, GEORGE NOTMAN, AND EDMUND COFFIN, AS EXECUTORS OF THE ESTATE OF JAMES DOUGLAS, DECEASED

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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1a

In United States District Court

Writ of error

UNITED STATES OF AMERICA, *ss:*

The President of the United States of America to the judges of the District Court of the United States for the Southern District of New York, greeting:

Because, in the record and proceedings, as also in the rendition of the judgment of a plea which is in the District Court, before you, or some of you, between Archibald Douglas, George Notman, and Edmund Coffin, as executors of the estate of James Douglas, deceased, plaintiffs, and William H. Edwards, collector of internal revenue, Second District, New York, defendant, a manifest error hath happened, to the great damage of the said Archibald Douglas, George Notman, and Edmund Coffin, as executors of the estate of James Douglas, deceased, plaintiffs, as is said and appears by their complaint, We, being willing that such error, if any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid, in this behalf, do command you, if judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the judges of the United States Circuit Court of Appeals for the Second Circuit, at the city of New York,

1b together with this writ, so that you have the same at the said place before the Judges aforesaid, on the 14th day of June, 1923, that the record and proceedings aforesaid being inspected, the said judges of the United States Circuit Court of Appeals for the Second Circuit may cause further to be done therein, to correct that error, what of right according to the law and custom of the United States ought to be done.

Witness, the honorable William H. Taft, Chief Justice of the United States, this 16th day of May, in the year of our Lord one thousand nine hundred and twenty three and of the Independence of the United States the one hundred and forty seventh.

[L. S.] ALEX. GILCHRIST, Jr.,
Clerk of the District Court of the United States of America, for the Southern District of New York, in the Second Circuit.

The foregoing writ is hereby allowed.

HENRY W. GODDARD,
U. S. District Judge.

1 In United States District Court for the Southern District of of New York

Summons

ARCHIBALD DOUGLAS, GEORGE NOTMAN AND EDMUND COFFIN, as executors of the estate of James Douglas, deceased, plaintiffs.

vs.

WILLIAM H. EDWARDS, COLLECTOR OF UNITED STATES internal revenue for the second district of the State of New York, defendant.

L 22 page 322.

To the above named defendant:

You are hereby summoned to answer the complaint in this action, and to serve a copy of your answer on the plaintiff's attorney within twenty days after the service of this summons, exclusive of the day of service; and in case of your failure to appear or answer,
2 judgment will be taken against you by default for the relief demanded in the complaint.

Witness, the Hon. Learned Hand, judge of the District Court of the United States for the Southern District of New York, at the city of New York this 9th day of August, 1920.

ALEX. GILCHRIST, Jr., *Clerk.*

DOUGLAS, ARMITAGE & MCCANN,
Plaintiffs Attorneys.

Office and post office address, 233 Broadway, Borough of Manhattan, New York City.

3 In United States District Court

[Title omitted.]

Complaint

The plaintiffs, by their attorneys, Douglas, Armitage & McCann, complaining of the defendant, respectfully show to this court and allege:

First. That at all times hereinafter mentioned, plaintiffs, Archibald Douglas, George Notman and Edmund Coffin, were and now are citizens of the United States and residents of the State of New York, and of the fourteenth, first, and second United States internal revenue districts of the State of New York.

Second. That James Douglas died on the 25th day of June, 1918, at Spuyten Duyvil, New York, and thereafter and on or about the 22nd day of August, 1918, his last will and testament,
4 together with three codicils were duly proved and duly admitted to probate in the Surrogates' Court of the county of Bronx of the State of New York; and pursuant to the provisions of said will and on or about the 22nd day of August, 1918, said Archibald Douglas, George Notman and Edmund Coffin, the plain-

tiffs herein, were duly appointed by said court and duly qualified as such and still are the executors of the estate of James Douglas.

Third. That on information and belief the said above named defendant is a citizen of the United States and a resident of the Borough of Manhattan, city, county and State of New York, and at all times hereinafter mentioned and still is the collector of the United States internal revenue for the second district of New York.

Fourth. That prior to the 1st day of March, 1913, said James Douglas was the owner and holder of 41,025 shares of the capital stock of Phelps Dodge & Company; that on or about the 2nd day of July, 1913, he purchased 25 shares of the capital stock of said Phelps Dodge & Company for the sum of $2,500 and thereafter and on or about the 1st day of April, 1917, said James Douglas, pursuant to a merger or consolidation hereinafter referred to, duly exchanged his said 41,050 shares of the capital stock of Phelps Dodge & Company for 41,050 shares of the capital stock of Phelps Dodge Corporation; that at the time of the death of the said James Douglas, on the 25th day of June, 1918, he was the owner and holder of the said 41,050 shares of the capital stock of the said Phelps Dodge Corporation, so received in exchange.

5 Fifth. That Phelps Dodge & Company was at all times hereinafter mentioned and prior to the 1st day of April, 1917, a corporation organized and existing under the laws of the State of New York, with a principal place of business at 99 John Street, in the Borough of Manhattan, city and State of New York.

Sixth. That prior to the 1st day of April, 1917, Copper Queen Consolidated Mining Company was a corporation organized on the 10th day of August, 1895, and existing under the laws of the State of New York, with an authorized capital stock of $2,000,000, all of which was issued and outstanding on the 1st day of April, 1917.

Seventh. That prior to the 1st day of April, 1917, Detroit Copper Mining Company of Arizona was a corporation organized on the 24th day of September, 1872, and existing under the laws of the State of Michigan, having an authorized capital stock of $1,000,000, all of which was issued and outstanding on the 1st day of April, 1917.

Eighth. That prior to the 1st day of April, 1917, Burro Mountain Copper Company was a corporation organized on the 20th day of January, 1914, and existing under the laws of the State of New Mexico, with an authorized capital stock of $8,000,000, all of which was issued and outstanding on the 1st day of April, 1917.

Ninth. That prior to the 1st day of April, 1917, Stag Canon Fuel Company was a corporation organized on the 8th day of De-
6 cember, 1905, and existing under the laws of the State of New Mexico, with an authorized capital stock of $500,000, all of which was issued and outstanding on the 1st day of April, 1917.

Tenth. That prior to the 1st day of April, 1917, Bunker Hill Mines Company was a corporation organized on the 3rd day of November, 1909, and existing under the laws of the State of West

Virgina, with an authorized capital stock of $1,000,000, of which $750,000 was issued and outstanding on the 1st day of April, 1917.

Eleventh. That prior to the 1st day of April, 1917, Phelps Dodge Mercantile Company was a corporation organized on the 12th day of December, 1911, and existing under the laws of the State of New York, with an authorized capital stock of $4,000,000, of which $2,000,000 was issued and outstanding on the 1st day of April, 1917.

Twelfth. That prior to and on the 1st day of March, 1913, the said Phelps Dodge & Company was the owner and holder of all the capital stock of the Copper Queen Consolidated Mining Company, the Detroit Copper Mining Company of Arizona, Burro Mountain Copper Company, Stag Canon Fuel Company, Moctezuma Copper Company, Bunker Hill Mines Company, and Phelps Dodge Mercantile Company.

Thirteenth. That on or about the 1st day of April, 1917, the directors and stockholders of Phelps Dodge & Company, Detroit Copper Mining Company of Arizona, Burro Mountain Copper Company, Stag Canon Fuel Company, Moctezuma Copper Company, Bunker Hill Mines Company, and Phelps Dodge Mercantile Company decided to consolidate into one company, in pursuance of which plan the capital stock of Copper Queen Consolidated Mining Company was duly increased to the sum of $50,000,000, divided into 500,000 shares with a par value of $100 each, its name was changed to the Phelps Dodge Corporation, and the assets thereof were transferred to and taken over by the said Phelps Dodge Corporation (Copper Queen Consolidated Mining Company) and all the companies thereupon were dissolved.

Fourteenth. That on the 1st day of March, 1913, the said shares of stock of Phelps Dodge & Company, so held as aforesaid by the said James Douglas, were of the value of $8,717,807.50, and at all times thereafter and until his death said stock has been of not less than said value.

Fifteenth. That for a long time prior to the 1st day of March, 1913, the said Phelps Dodge & Company was the owner and holder, and operator in its own name and through its holdings in the several corporations above mentioned, of various valuable copper mines containing copper ore, and that the value of the said copper mines was on the 1st day of March, 1913, at least the sum of $132,285,000.00.

Sixteenth. That subsequent to the 1st day of March, 1913, and prior to the 28th day of December, 1917, the said Phelps Dodge & Company and said several companies mined and extracted copper ore from the mines and the ore bodies that were known to exist in said mines on February 28, 1913, and sold said copper and copper ore so produced and out of the proceeds thereof set aside yearly fixed sums which represented the value of the said ore in the ground on the 1st day of March, 1913, which sums were for a depletion reserve to return the said capital value of the said ore to said corporation and their stockholders, and said reserves so created by the said corporations were maintained intact and held by

said corporations up to the 28th day of December, 1917, except as hereinafter stated.

Seventeenth. That at a meeting of the board of directors of the said Phelps Dodge Corporation, held on the 13th day of September, 1917, and after said consolidation as aforesaid, the said directors, acting under their duly constituted authority, declared out of the said reserve funds so created for depletion and which represented the proceeds of the sale of the capital assets of said several companies as represented by said ore bodies existing on March 1, 1913, a depletion dividend, which dividend was designated and described as "a distribution from the reserve fund for depletion" as follows:

"Whereas this company in accordance with the income tax section of the tariff act of 1913, and with the income tax law of September 8, 1916, has yearly, in computing its income, deducted therefrom a reasonable allowance for depletion of its mines, based upon the fair market volume thereof as of March 1, 1913; and

"Whereas the income tax law and the rulings of the Department of Internal Revenue provide for a separation of said deduc-
9 tions from income and provide further that payments to stockholders from said depletion account will be a return of capital invested, and are not subject to income tax in the hands of the shareholders:

"Therefore, resolved that this company distribute among its stockholders from said depletion account, three dollars a share, to be paid on September 28, 1917, to stockholders of record on September 24, 1917, the total amount so paid to be deducted from said depletion account."

Eighteenth. That thereafter the said Phelps Dodge Corporation duly paid and distributed out of said depletion funds or reserves so created by said several companies the said depletion dividend to its stockholders, and the said James Douglas, as such stockholder of said corporation, and the owner and holder of the shares of stock as aforesaid, duly received, on the 28th day of September, 1917, the sum of one hundred twenty-three thousand one hundred and fifty ($123,150) dollars as his proportionate share in such depletion dividend.

Nineteenth. That at a meeting of the board of directors of said Phelps Dodge Corporation held on the 13th day of December, 1917, and after said consolidation as aforesaid, the said directors, acting under their duly constituted authority, declared out of the said reserve funds so created for depletion and which represented the proceeds of the sale of the captial assets of said several companies as represented by said ore bodies existing on March 1, 1923, a depletion dividend, which dividend was designated and de-
10 scribed as "a distribution from the reserve fund for depletion" as follows:

"Whereas this company, in accordance with the income tax section of the tariff act of 1913, and with the income tax law of September 8, 1916, has yearly, in computing its income, deducted

therefrom a reasonable allowance for depletion of its mines, based upon the fair market value thereof as of March 1, 1913; and

"Whereas the income tax law and the rulings of the Department of Internal Revenue provide for a separation of said deductions from income and provide further that payments to stockholders from said depletion account will be a return of capital invested and are not subject to income tax in the hands of the shareholders:

"Therefore, resolved that this company distribute among its stockholders from said depletion account, five dollars per share, to be paid on December 28, 1917, to stockholders of record on December 18, 1917, the total amount so paid to be deducted from said depletion account."

Twentieth. That thereafter the said Phelps Dodge Corporation duly paid and distributed out of said depletion funds or reserves so created by said several companies the said depletion dividend to its stockholders and the said James Douglas, as a stockholder of the said corporation and as the owner and holder of the shares of stock as aforesaid, duly received on the 28th day of December, 1917, the sum of two hundred five thousand two hundred fifty ($205,250)
11 dollars as the proportionate share in such depletion distribution.

Twenty-first. That the said dividends were so declared and paid out of the said depletion reserve funds as a distribution of capital assets to the stockholders and as a proper reduction of the value of their capital stock in the said corporation and return to them according to their interest in the assets of the corporation on the 1st day of March, 1913. That the said dividends were declared as a dividend from the reserve fund for depletion and not in any sense as a distribution of income or profit and that they were not paid out of the profits or earnings accrued since the 1st day of March, 1913, but were paid entirely out of reserve fund so created, which represented the sale of capital assets and the amount received therefor, equal to the value of these capital assets on the 1st day of March, 1913, and not out of any excess or increase in value or profits made since March 1, 1913.

Twenty-second. That on or about the 28th day of March, 1918, James Douglas duly made and filed with this defendant, the said collector of the United States internal revenue for the second district of New York, his return of income received during the year ending December 31, 1917, and to his said return he attached a statement as follows.

"NOTE.—In addition to the monies received during the year 1917 as reported in the foregoing individual income tax return for 1917, I have received the following amounts:

12

1917		
Sept. 28.	Rec'd as a stockholder from the Phelps Dodge Corporation, 99 John Street, New York, N. Y., a distribution from reserve from depletion	$123,150
Dec 28.	Do	205,250
	Total	328,400"

Twenty-third. That the levy and collection on the part of the Treasury Department the defendant of the income tax on the sum of $329,700 is an attempt to levy a direct tax upon the capital or property of the late James Douglas, but without apportionment among the States in proportion to the population, as required by subdivision 4, secton 9, of article 1 of the Constitution of the United States. That said levying of a tax on the said $329,700 is an attempt to tax as income what was in fact capital or property of the late James Douglas and not income within the provisions of article 16 of the Constitution of the United States.

Twenty-fourth. That the said title 1 of the act of September 8, 1916, as amended by the law of October 3, 1917, and in particular section 31 thereof, as so construed and applied by the Treasury Department in respect to the levying of the said tax on said $329,700 is an attempt to levy a tax upon income which had accrued or been earned before March 1, 1913, and contrary to the sixteenth amendment of the Constitution of the United States.

13 Twenty-fifth. That the said title 1 of the act of September 8, 1916, as amended by the law of October 3, 1917, and in particular section 31 thereof, as so construed and applied by the Treasury Department in respect to the levying of the said tax on said $329,700 is an attempt to levy and collect a tax upon the capital or property of the late James Douglas owned by him before March 1, 1913, and therefore contrary to the provisions of the Constitution of the United States.

Twenty-sixth. That the said titles of said acts of Cangress make, in respect of tax, arbitrary and unreasonable discrimination, exceptions, exemptions, and classifications, in violation of fundamental requirements of the Constitution of the United States, and the requirement therein that taxes shall be uniform throughout the United States.

Twenty-seventh. In sundry other particulars, both in form and substance, the said acts of Congress purporting to impose said tax, and the rules and regulations promulgated in connection therewith by the Commissioner of Internal Revenue or the Secretary of the Treasury, and the demand and requirement to make said return and pay said sum, are all and each of them illegal and unconstitutional.

Twenty-eighth. That at all times herein mentioned the said Phelps Dodge Corporation was and is a going concern and there has been no dissolution, distribution, or liquidation of its capital assets, except as herein set forth.

Twenty-ninth. That prior to the 28th day of December,
14 1917, there had been no distribution of the capital assets of any of the said corporation to the said James Douglas, nor to any other stockholders, nor has there been any other distribution of the capital assets, except the two distributions hereinbefore set forth.

Thirtieth. That thereafter the above-named defendant, as collector as aforesaid, upon an audit of the return of income for the year

1917 of the said James Douglas, advised plaintiffs as executors of said James Douglas, deceased, by a notice in writing dated the 20th day of February, 1919, a copy of which is hereto annexed and marked "Exhibit I," that the amount of $329,805 was income for the year 1917, and included in said income were the two depletion dividends so paid by the said corporation as aforesaid, and taxable as such, and assessed a tax against the said James Douglas amounting to $173,579.72 based on additional alleged income, and further notified said James Douglas that failure to pay the said sum would cause a 5% penalty to accrue, together with interest at 1% per month from the date due until paid.

Thirty-first. That thereafter and on or about the 16th day of May, 1919, the above-named plaintiffs, as executors as aforesaid, duly paid said tax of $173,579.72 to the said defendants under protest and in order to avoid the penalties threatened by him and imposed by law for nonpayment, which said protest was in writing and filed with the defendant at the time of the payment of the said tax, copy of which protest is hereto attached and marked "Exhibit 2."

Thirty-second. That thereafter and on or about the 24th
15 day of November, 1919, the above-named plaintiffs, as executors as aforesaid, duly made and filed with the Commissioner of Internal Revenue a written claim for refund of taxes on Form 46, wherein and whereby they demand that the said amount of $173,579.72 be refunded and paid back to the said plaintiffs as a tax illegally and improperly assessed and collected.

Thirty-third. That thereafter and on or about the 19th day of April, 1920, said appeal to the Commissioner of Internal Revenue and claim for refund of the said tax was duly rejected in writing, copy of which rejection is hereto attached and marked "Exhibit 3."

Thirty-fourth. That no part of said illegal tax of $173,579.72 has been refunded or repaid, although the same has been duly demanded.

Thirty-fifth. That this is a suit of civil nature at common law and arises under the Constitution and laws of the United States and under the laws of the United States provided for internal revenue.

Wherefore, plaintiffs demand judgment against the above-named defendant in the sum of $173,579.72 together with interest on same from the 16th day of May, 1919, and costs and disbursements of this action.

DOUGLAS, ARMITAGE & MCCANN,
Attorneys for Plaintiffs.

Office and post office address, 233 Broadway, Borough of Manhattan, New York City.

16 [Jurat showing the foregoing was duly sworn to by Edmund Coffin. Omitted in printing.]

17 EXHIBIT "1" (ATTACHED TO COMPLAINT)

IT:RAA:P
30

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, February 20, 1919.

DOUGLAS, ARMITAGE & MCCANN.
Woolworth Building, 233 Broadway,
New York, N. Y.

SIRS: An investigation of the income tax liability of the late James Douglas, 99 John Street, New York City, N. Y., for the years 1915 to 1917, inclusive, based on a revenue agent's report and an audit in this office, indicates that there are further taxes due of $85.19 for the year 1915, $1,059.01 for 1916 and $173,579.72 for 1917.

The amended returns should read as follows:

1915

Gross income		$1,201,836.98
General deductions		81,268.20
Net income		1,120,568.78
Dividends	$1,071,257.37	
At source	89,176.42	
Exemption	4,000.00	
Total		1,164,433.79
18 Normal tax	None.	
Additional tax	57,284.12	
Tax previously paid	57,198.93	
Additional tax due	85.19	

1916

Gross income		$1,899,675.99
General deductions		110,268.81
Net income		1,789,407.18
Dividends	$1,757,561.97	
Exemption	4,000.00	
Total		1,761,561.97
Income subject to normal tax		27,845.21
Normal tax	$556.90	
Super tax	172,728.86	
Total tax due	173,285.76	
Tax paid	172,226.66	
Additional tax paid	1,059.10	

1917

Dividends 1913–1915	$915.00	
Dividends 1916	319,860.78	
19 Gross income		$1,566,114.09
Deductions		31,883.00
Net income		1,534,231.09
Less excess profits tax		2,520.00
Total		1,531,711.09
Less contributions		277,873.03
		1,253,838.06
Less 1917 dividends		1,427,987.65
Normal tax	None.	
Super tax	$590,141.22	
Tax on 1915 div	54.90	
Tax on 1916 div	35,921.67	
Excess profits tax	2,520.00	
Total	628,637.79	
Tax paid	455,058.07	
Additional tax due	173,579.72	

Assessment of the above amounts will be made on the next list sent the collector of your district.

Respectfully,

(Signed) HOMER S. PACE,
Acting Deputy Commissioner.

20 EXHIBIT "2" (ATTACHED TO COMPLAINT)

MAY 16, 1919.

COLLECTOR OF INTERNAL REVENUE.
For the Second District, New York.

James Douglas income tax—1917

DEAR SIR: We, George Notman, Edmund Coffin, and Archibald Douglas, executors of the estate of James Douglas, deceased, late of New York County, in the State of New York, herewith under duress and with protest and to avoid threatened penalty, which would in case of nonpayment on or before May 16th, 1919, be imposed in pursuance of notice received from you, a copy of said notice being hereto annexed, do make payment to you of the sum of $173,579.72 heretofore and now represented by you to be lawfully required and demanded of us and to be due to the United States under and in accordance with title 1 of an act of Congress of September 8, 1916, as amended October 3, 1917, as a tax upon and in respect to the net income of said James Douglas, deceased, and to have been lawfully assessed against him as such a tax for the year 1917.

But we hereby protest against being required to pay said sum and each and every part thereof, and we represent and declare that such payment is made under duress and only to avoid penalties and for-

feitures, the enforcement of which has been and is now threatened by representatives of the United States and by you and by
21 said act of Congress and by other acts which you have represented and do now represent as supporting your said demand.

We hereby particularly set forth and declare that the demand for said payment and the enforcement thereof are both unlawful and deprive us of rights secured to us by the Constitution and laws of the United States for the reasons hereinafter stated among others, but not excluding any other reasons which might now be given:

No lawful assessment of the said sum against us has ever been made, and said sum is not now due or owing to the United States by us either individually or as executors of the last will and testament of James Douglas, deceased, as a tax lawfully provided for by said act or acts.

That Douglas, Armitage & McCann, attorneys for the estate of James Douglas, received from the Treasury Department at Washington, under date of April 22, 1919, a communication signed J. H. Callan, assistant to the Commissioner, the last paragraph of which reads as follows:

"The increase of gross income in 1917 by over $329,000 is the result of including as 1917 income the amount as a depletion dividend, and not returned, examination of the accounts of the Phelps Dodge Co. paying this dividend, showing a surplus and undivided profits available for such dividend greatly in excess of this amount and which under the law will be deemed to have been paid from such reserve."

The undersigned state that the amount of $328,400, paid by Phelps Dodge Corporation to the late James Douglas in the
22 year 1917 was not a distribution from the surplus or undivided profits of Phelps Dodge Corporation, but was a payment out of the reserve for depletion set aside by said corporation in accordance with the income tax law applicable to corporations and that it was a distribution to the stockkholders and to said James Douglas of capital and not income.

The undersigned state that the amount of $1,000 paid by Calumet & Arizona Mining Company to the late James Douglas in the year 1917 was not a distribution from surplus or undivided profit of Calumet & Arizona Mining Company, but was a payment out of the reserve for depletion set aside by said corporation in accordance with the sections of the income tax law applicable to corporations, and that it was a distribution to the stockholders and to said James Douglas of capital and not income.

The undersigned state that the amount of $500 paid by Shatuck-Arizona Copper Company to the late James Douglas in the year 1917 was not a distribution from the surplus or undivided profits of the Shatuck-Arizona Copper Company, but was a payment out of the reserve for depletion set aside by said corporation in accordance with the sections of the income tax law applicable to corporations, and that it was a distribution to the stockholders and to said James Douglas of capital and not income.

That the levy on the part of the Treasury Department of an income tax on the sum of $329,700 is an attempt to levey a direct tax upon the capital or property of the late James Douglas, but without apportionment among the States in proportion to the population, as required by subdivision 4, section 9, of article 1 of
23 the Constitution of the United States.

That said levying of a tax on the said $329,700 is an attempt to tax as income what was in fact capital or property of the late James Douglas and not income within the provisions of Article XVI of the Constitution of the United States.

That the said title 1 of the act of September 8, 1916, as amended by the law of October 3, 1917, and in particular sec. 31 thereof, as so construed and applied by the Treasury Department in respect to the levying of the said tax on said $329,700, is an attempt to levy a tax upon income which had accrued or been earned before March 1, 1913, and contrary to the sixteenth amendment of the Constitution of the United States.

That the said title 1 of the act of September 8, 1916, as amended by the law of October 3, 1917, and in particular sec. 31 thereof as so construed and applied by the Treasury Department in respect to the levying of the said tax on said $329,700, is an attempt to levy a tax upon the capital or property of the late James Douglas, owned by him before March 1st, 1913, and therefore contrary to the provisions of the Constitution of the United States.

That the said titles of said acts of Congress make, in respect of said tax, arbitrary and unreasonable discriminations, exceptions, exemptions, and classifications, in violation of fundamental requirements of the Constitution of the United States and the requirements therein that taxes shall be uniform throughout the United States.

24 In sundry other particulars, both in form and substance, and said act of Congress purporting to impose said tax, and the rules and regulations promulgated in connection therewith by the Commissioner of Internal Revenue of the Secretary of the Treasury and the demand and requirement to make said return and pay said sum, are all and each of them illegal and unconstitutional, and notice is hereby given that in such time and in such manner as may be advisable, appropriate proceedings, including any action in law or in equity that may be deemed constitutional, will be taken against you and by any and all parties in interest in said sum and to preserve and protect all our rights and interest thereunto appertaining.

Wherefore we have signed this protest on the 16th day of May, 1919.

GEORGE NOTMAN,
EDMUND COFFIN,
ARCHIBALD DOUGLAS,
Executors of the estate of James Douglas, deceased.
By GEORGE NOTMAN.

25 EXHIBIT "3" (ATTACHED TO COMPLAINT)

IT:CL—BKH

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, April 19, 1920.

ARCHIBALD DOUGLAS ET AL.,
Executors of the Estate of James Douglas, deceased,
99 John Street, New York, N. Y.

SIRS: The claim filed by you as executors of the estate of James Douglas, deceased, for the refunding of $173,579.72 a portion of the individual income tax paid for the year 1917, has been examined.

You contend that dividends received during the taxable year from Phelps Dodge Corporation, the Calumet & Arizona Mining Company, and the Schatuck-Arizona Copper Company, declared out of a reserve for depletion of mining property did not represent taxable income to the recipient, but, on the contrary, represented a return of capital.

Section 31 of the revenue act of 1916, amended by section 1211 of the act of October 3, 1917, provided:

"(a) That the term 'dividends' as used in this title shall
26 be held to mean any distribution made or ordered to be made by a corporation, * * * out of the earnings or profits accrued since March 1, 1913, and payable to shareholders. * * *

"(b) Any distribution made to the shareholders or members of a corporation, * * * in the year 1917, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus and shall constitute a part of the annual income of the distribution for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, * * *. This subdivision shall not apply to any distribution made prior to August 6, 1917, out of earnings or profits accrued prior to March 1, 1913."

From the information secured by this bureau from the records of the corporation making the payments of dividends involved in your claim it appears that their surplus and undivided profits were sufficient to cover all distributions made during the year 1917. For this reason it is held that the payments received by Mr. Douglas were not a return of capital, but represented a distribution of earnings upon the capital stock which he held.

Your claim is accordingly hereby rejected.

Respectfully,

(Signed) WM. M. WILLIAMS,
Commissioner.

27 In United States District Court

[Title omitted.]

Answer

Defendant above named by Francis G. Gaffey, United State attorney for the Southern District of New York, his attorney answering the complaint herein, alleges:

I. Defendant denies that he has any knowledge or information thereof sufficient to form a belief as to each and every allegation contained in paragraphs numbered "first," "second," "fifth," "sixth," "seventh," "eighth," "ninth," "tenth," "eleventh," "twelfth," "thirteenth," "fourteenth," "fifteenth," "sixteenth," "twenty-eighth," and "twenty-ninth" of the complaint.

II. Upon information and belief defendant denies each and every allegation contained in paragraphs numbered "twenty-first,"
28 "twenty-third," "twenty-fourth," "twenty-fifth," "twenty-sixth," and "twenty-seventh" of the complaint.

III. Answering the allegations of paragraph numbered "fourth" of the complaint, defendant admits that during the year 1917 said James Douglas was a stockholder in Phelps Dodge Corporation except as herein above specifically admitted, defendant denies that he has any knowledge or information thereof sufficient to form a belief as to each and every allegation in said paragraph numbered "fourth" contained.

IV. Answering the allegations of paragraph numbered "seventeenth" of the complaint, upon information and belief, defendant denies that on the 13th day of September, 1917, the directors of Phelps Dodge Corporation declared a depletion dividend out of the reserve funds created for depletion and which represented the proceeds of the sale of the capital assets of the several companies as represented by the ore bodies existing on March 1, 1913; except as hereinabove specifically denied, defendant denies that he has any knowledge or information thereof sufficient to form a belief as to each and every allegation in said paragraph numbered "seventeenth" contained.

V. Answering the allegations of paragraph numbered "eighteenth" of the complaint, defendant admits that on or about the 28th day of September, 1917, said Phelps Dodge Corporation paid, and said James Douglas received, a dividend in the sum of one hundred twenty-three thousand one hundred and fifty dollars
29 ($123,150); upon information and belief defendant denies that said dividend was a depletion dividend, or that the same was paid or distributed out of the depletion funds or reserves created by the several companies; except as herein above specifically admitted or denied, defendant denies that he has any knowledge or

information thereof sufficient to form a belief as to each and every allegation in said paragraph numbered "eighteenth" contained.

VI. Answering the allegations of paragraph numbered "nineteenth" of the complaint, upon information and belief defendant denies that on the 13th day of December, 1917, the directors of Phelps Dodge Corporation declared a depletion dividend out of the reserve funds created for depletion, and which represented the proceeds of the sale of the capital assets of the several companies as represented by the ore bodies existing on March 1, 1913; except as hereinabove specifically denied, defendant denies that he has any knowledge or information thereof sufficient to form a belief as to each and every allegation in said paragraph numbered "nineteenth" contained.

VII. Answering the allegations of paragraph numbered "twentieth" of the complaint, defendant admits that on the 28th day of December, 1917, said Phelps Dodge Corporation paid, and said James Douglas received a dividend in the sum of two hundred five thousand two hundred and fifty dollars ($205,250); upon information and belief defendant denies that said dividend was a depletion dividend or that the same was paid or distributed out of the
30 depletion funds or reserves created by the several companies; except as herein above specifically admitted or denied, defendant denies that he has any knowledge or information thereof sufficient to form a belief as to each and every allegation in said paragraph numbered "twentieth" contained.

VIII. Answering the allegations of paragraph numbered "thirtieth" of the complaint, defendant admits that plaintiffs were duly advised that the amount of $329,805 was income for the year 1917 by a notice in writing dated the 20th day of February, 1919, in substantially the form of Exhibit 1 annexed to the complaint, but upon information and belief defendant denies that plaintiffs were so advised by defendant as collector of internal revenue or in any other capacity.

IX. Answering the allegations of paragraph numbered "thirty-first" of the complaint defendant admits that payment of said tax of $173,579.72 was made to defendant under protest, which protest was in writing and filed with defendant in substantially the form of Exhibit 2 annexed to the complaint, but for greater certainty defendant begs leave to produce upon the trial the original or a certified copy of said protest; defendant denies that he has any knowledge or information thereof sufficient to form a belief as to the allegation that said payment was made in order to avoid the penalties alleged to have been threatened by defendant and imposed by law for non-payment.

X. Answering the allegations of paragraph numbered "thirty-fourth" of the complaint, upon information and belief, de-
31 fendant denies that said tax of $173,579.72, or any part thereof, was illegal.

Wherefore defendant demands judgment dismissing the complaint herein together with the costs and disbursements of this action.

FRANCIS G. CAFFEY,
United States Attorney for the Southern District of New York,
Attorney for Defendant,

Office & P. O. address, U. S. Courts & Post Office Building, Borough of Manhattan, New York City.

[Jurat showing the foregoing was duly sworn to by W. H. Edwards. Omitted in printing.]

32 In United States District Court

[Title omitted.]

Minute entry

Douglas, Armitage & McCann, attorneys for the plaintiffs; William Hayward, United States attorney and Richard S. Holmes, assistant United States attorney, attorneys for the defendant.

Thereafter, on February 20, 1922, both sides consented to try the case by a jury of one.

Jury of one duly empanelled and sworn.

Facts agreed upon.

32a Each side moves for a direction of a verdict.

Thereafter, on December 19, 1922, by direction of the court, verdict for the defendant.

An extract from the minutes.

[SEAL.] ALEX. GILCHRIST, Jr., *Clerk.*

In United States District Court

[Title omitted.]

Douglas, Armitage & McCann, attorneys for plaintiffs; William Hayward, United States attorney, attorney for defendant; Richard S. Holmes, special assistant U. S. attorney; James J. Cosgrove, special attorney, Bureau of Internal Revenue, of counsel.

Memorandum opinion

MACK, circuit judge:

This suit is brought by the executors of James Douglas, deceased, to recover the sum of $173,579.72 assessed as income tax
32b against funds received by the decedent as part of so-called "depletion distributions" made by the Phelps Dodge Corporation to its shareholders in September and December, 1917. It is the contention of the plaintiffs that these distributions were not dividends in the ordinary course of the business, but were liquidating dividends specifically made from a depletion reserve set up by the corporation under the direction of, and in accordance with, the

regulations of the Treasury Department, and, therefore, constituted return of capital to its stockholders. The solicitor for the Commissioner of Internal Revenue rejected this contention on the ground that under section 31 (b) of the revenue act of 1916, added by section 1211 of the act of October 3, 1917, a corporation could not declare a dividend out of profits earned prior to March 1, 1913, or from a depletion reserve—and thereby enable the recipients to escape the tax thereon,—at a time when the company had earnings in its surplus fund which accrued to it on or after March 1, 1913, from which the dividend or dividends could have been paid, in any event not without a reduction of its capital stock.

Plaintiff's Exhibit D, which is annexed hereto as Schedule I, gives a summary of the changes in the financial condition of the Phelps Dodge Corporation during the period 1912–1917.

It appears therefrom that on March 1, 1913, the Phelps Dodge Corporation[1] had net assets aggregating $153,275,606.69; it
32c had capital stock outstanding of a par value of $45,000,000.-000.00 and surplus of $108,275,606.69, of which it is agreed $45,000,000.00 represented a paid-in surplus, leaving an earned surplus of $63,275,606.69.

The dividends distributed to the stockholders in 1913 exceeded the net profits of the corporation for that year by $1,051,883.14; in 1914 by $2,653,541.90; and in 1915 by $3,376,476.11. In 1916, however, the net profits exceeded the dividends by $3,125,621.67, and in 1917 the net profits exceeded the dividends, including the so-called depletion dividends, by $2,342,487.06.

It is the contention of the plaintiffs that the directors in each of these years believed they were paying dividends out of the company's net income, inasmuch as the depletion was taken on the books of the company at a considerably less amount than that ultimately allowed by the Government on March 2, 1920. Plaintiffs also point out that the total distributions to the stockholders during the years 1913 to 1917 exceeded the net income for those years on the basis of the depletion reserves allowed by the Government, by $1,616,000.00.

The dividends or distributions declared on September 13, 1917, and December 13, 1917, and payable on the 28th of these months, purported to be made from a depletion account. The resolutions authorizing the September distribution read as follows:

"Whereas this company, in accordance with the income tax section of the tariff act of 1913, and with the income tax law of September 8,
1916, has yearly, in computing its income, deducted therefrom
32d a reasonable allowance for depletion of its mines, based upon the fair market value thereof as of March 1, 1913; and

Whereas the income tax law and the rulings of the Department of Internal Revenue provide for a separation of said deductions from

[1] I refer to the Phelps Dodge Corporation throughout this opinion, disregarding change in name and corporate readjustments and consolidations not material for the disposition of this case.

income and provide further that payments to stockholders from said depletion account will be a return of capital invested, and are not subject to income tax in the hands of the shareholders;

Therefore, resolved that this company distribute among its stockholders from said depletion account three dollars a share, to be paid on September 28, 1917, to stockholders of record on September 24, 1917, the total amount so paid to be deducted from said depletion account."

The December resolution was identical in form.

These depletion dividends, when declared, were credited on the books of the corporation to a new account which was opened, entitled "Distribution from reserve for depletion," and when the dividends were paid, the cash account was credited and the account entitled "Distribution from reserve for depletion" was debited. Although the corporation had at the time two depletion accounts, one called the "Depletion reserve" and the other "Ore reserve," neither the regular "Depletion reserve" account nor the "Ore reserve" account was charged with the amount of the depletion dividends; no part thereof was deducted from either of these accounts upon the
32e books of the company, and the invested capital of the corporation was not reduced in the excess tax return filed by it, by the amount of any depletion dividends declared and paid in 1917; naturally no reduction in the capital stock of the corporation was thereby effected.

The so-called depletion dividend of September amounted to $1,350,000.00 and the plaintiffs' testator, Dr. James Douglas, received in respect of the 41,050 shares of the capital stock of the corporation held by him $123,150.000. The December dividend amounted to $2,250,000.00 and Dr. Douglas received $205,250.00.

Dr. Douglas, in his 1917 income tax return, included in his taxable income all dividends received from the corporation, except the two depletion dividends with reference to which he inserted the following note:

"NOTE.—In addition to the monies received during the year 1917 as reported in the foregoing individual income tax return for 1917, I have received the following amounts:

1917		
Sept. 28.	Rec'd as a stockholder from the Phelps Dodge Corporation, 99 John Street, New York, N. Y., a distribution from reserve from depletion	$123,150
Dec. 28.	Do	205,250
	Total	328,400"

(1) Plaintiffs, pointing out that the total earnings of the
32f company from March 1, 1913, to December 31, 1917, were $50,133,207.58; that the distributions made during the same period were $51,750,000.00, leaving an excess of distributions over earnings of $1,616,000.000, contend that in no circumstances can Dr. Douglas' share of $1,616,000.00 of the amount distributed as

depletion dividends in 1917 be regarded as taxable income accruing subsequent to March 1, 1913. The contention when analyzed, however, is clearly untenable. Although the directors may have distributed in dividends in 1913, 1914, and 1915 sums in excess of the net earnings for those years, the earned surplus accumulated by the corporation readily enabled them to do so. Under the income tax act of 1913 even these excess distributions from earnings accumulated prior to March 1, 1913, were subject to tax. Lynch v. Hornby, 247 U. S., 339. The law was changed in 1916 and dividends from surplus accumulated prior to March 1, 1913, were exempted from tax. Consequently, if in 1916 and 1917, the corporation had distributed as dividends sums in excess of their net earnings in those years, such excess would have been exempt. But, as has been indicated, the net earnings in both 1916 and 1917 exceeded all the distributions made in those years.

Inasmuch as the net income for 1913 to 1915 was less than the dividends of those years, the excess must have been paid from the surplus on hand March 1, 1913. It was, therefore, part of the dividends of these years and not the dividends of 1916 and 1917, that came from this surplus.

It follows that before December 31, 1915, there had been expended in dividends during 1913, 1914, and 1915, the entire net earn-
32g ings for those years and, in addition thereto, a part of the surplus accumulated prior to March 1, 1913.

If the dividends paid in the year 1916 are to be charged against the surplus theretofore accumulated and not against the current earnings of that year, the entire net earnings of that year, $17,750,621.67, would form part of the surplus as of December 31, 1916, an amount more than sufficient to pay both the dividends and depletion distributions made in 1917.

If, however, the dividends of 1916 are properly chargeable to the current net earnings of that year, then only $3,125,621.67 of the surplus as of December 31, 1916, would have come from the net earnings of 1916 or of the period subsequent to February 28, 1913. In that case, if the dividends paid in 1917 are not properly chargeable against the net earnings of that year, the ordinary dividends of 1917 paid prior to the depletion distributions would more than have exhausted this $3,125,621.67, and in that event plaintiff's contention that the depletion distribution necessarily came from surplus accumulated prior to March 1, 1913, would be sound.

(2) It is necessary, therefore, to consider next the interpretation of the act in question. And as to that (a) whether ordinary dividends are to be deemed payable only out of accumulated profits and surplus as shown by the last bookkeeping determination, or also, and in the first instance, either in whole or in part out of the current net earnings of the year in which they are paid, regardless of whether at the time of payment it shall have been actually and
32h finally determined by inventory and balancing of books that sufficient net profits therefor have been earned; (b) even if

ordinary dividends are chargeable first to current undetermined net earnings, whether depletion distributions, unlike such ordinary dividends, may nevertheless be paid out of a depletion reserve or out of surplus earned prior to March 1, 1913, as capital distributions, without reduction of the capital stock.

(a) Section 31 of the revenue act of 1916, as supplemented by the revenue act of 1917, reads as follows:

"SEC. 31(a) That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association, or insurance company, which stock dividend shall be considered income, to the amount of the earnings or profits so distributed.

(b) "Any distribution" made to the shareholders or members of a corporation, joint-stock company or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which
32i received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association, or insurance company, but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed in stock dividends or otherwise, exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made. This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen."

It seems to me that the congressional intent is clear. Distributions to shareholders are to be regarded as made from current earnings and the most recently accumulated surplus: Congress, in my judgment, did not intend to lay down a narrow rule to be whittled away by technical definitions of the terms surplus, undivided profits, dividends, and distributions. Nor did it intend to recite a mere prima facie rule which could be arbitrarily set aside by the form of the bookkeeping entries. It is to be assumed that Congress desired that, so far as possible, the tax should be regulated by the substance of things and not their form, and that taxation should not fall more lightly upon one man than upon another because of ingenuity in bookkeeping methods.

32j If plaintiffs' contention that "the most recently accumulated undivided profits or surplus" is necessarily limited to such profits and surplus as are definitely ascertained by closing the books, gross inequality might result dependent upon the number of times

in a fiscal year that the books are closed. Furthermore, if the contention were sound not merely as a construction of the act but—and plaintiffs so urge—as the proper relation of dividend distributions to earnings from the standpoint of sound accounting principles and usual business practice, it would be applicable also to the 1916 dividends. The result, as heretofore stated, would be that the entire large earnings of 1916 would be applicable to the 1917 distributions, both ordinary and depletion. True, in that case, there would be a recovery because the tax would have been assessable at 1916 instead of 1917 rates.

The practice, however, of this very corporation and of the deceased stockholder indicates what, in my judgment, is the sounder view. The company, in its annual report, while stating that the earliest dividends, paid in March, 1917, were paid out of profits accrued during the year 1916, declared that the regular ordinary and extra dividends—these do not include the depletion distributions—paid in June, September and December, 1917, were paid out of earnings for the year 1917. And Dr. Douglas, as heretofore stated, so returned them in his income tax report for the year 1917.

Though the books were not balanced and net profits carried into the undivided profits and surplus account at the time of the payment of any of these dividends, it was obvious, as it ordi-
32k narily would be, that large current profits were being made and distributed from time to time throughout 1917.

In my judgment, Congress did not intend, and there is nothing in the legislative history of the enactment of section 31 (b) reasonably considered that would indicate that Congress intended, to use the terms undivided profits or surplus in a strict technical sense which would exclude from their embrace current profits. If Congress had so intended, it would have resulted in nearly all corporate dividends declared in the war year 1917 being taxed at the lower rates prescribed for 1916 or not being taxed at all.

Subsequent legislation indicates not a change but a clarification of that legislative intent. Section 201 (b) of the revenue act of 1918 provided:

"Any distribution shall be deemed to have been made from earnings or profits unless all earnings and profits have first been distributed."

And the same numbered section of the revenue act of 1921 is expressive of the same intent.

"For the purposes of this act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits, accumulated since February 28, 1913, but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the
321 earnings and profits accumulated since February 28, 1913, have been distributed. If any such tax-free distribution has been made the distributee shall not be allowed as a deduction from

gross income any loss sustained from the sale or other disposition of his stock or shares, unless, and then only to the extent that, the basis provided in section 202 exceeds the sum of (1) the amount realized from the sale or other disposition of such stock or shares, and (2) the aggregate amount of such distributions received by him thereon."

That undivided profits as used in section 31 (b) was intended to include current profit earned during the current year, was certainly the contemporaneous construction placed upon it not only by Dr. Douglas, but by taxpayers generally. Furthermore, article 107 of Treasury Regulations 33, Revised, provided:

"Any distribution made to shareholders in the year 1917 or subsequent years (except any distribution of dividends made prior to August 6, 1917, out of earnings or profits accrued prior to Mar. 1, 1913) shall be deemed to have been made from the most recently accumulated undivided surplus or profits, and shall constitute income of the distributee for the year in which received, and shall be taxed to such distributee at the rates prescribed by law for the years in which such surplus or profits were earned by the distributing corporation.

Thus, if a corporation distributed dividends in 1917, such
32m dividends will be deemed to have been paid from the earnings of 1917, and the recipient, if an individual, will be liable to additional tax, if any, and if a corporation, to income tax, at the rates for the year 1917, unless it is shown to the satisfaction of the Commissioner of Internal Revenue that at the time such dividends were paid, the earnings up to that time were not sufficient to cover the distribution, in which case the excess over the earnings of the taxable year will be deemed to have been paid from the most recently accumulated surplus of prior years, and will be taxed at the rate or rates for the year or years in which earned.

A corporation declaring and paying dividends out of a surplus or earnings accumulated over a period of years, should make a record in its books of the amount of dividends paid out of each year's undistributed surplus or profits, and advise the stockholders accordingly, in order that the dividends received by them may be taxed at the respective rates prevailing during the years in which the surplus or profits so distributed were earned. * * *"

The Commissioner of Internal Revenue was not satisfied that at the time these so-called depletion dividends were paid, the earnings up to that time were not sufficient to cover such distribution. The audit of the 1917 books indeed proves that the net earnings of 1917 were more than sufficient to pay all the distributions made, and there is nothing to indicate that a pro rata apportionment thereof is not in accordance with the facts. Under such ap-
32n portionment the net earnings were sufficient at the respective times for all of the distributions.

(b) Depletion distributions without reduction of capital stock are not to be differentiated in the matters here under consideration from ordinary dividends. Depletion reserves are a mere bookkeeping account: the distribution comes from the general assets of the company: it results in a reduction thereof. If a similar reduction were made in the capital stock liability by some method permissible under the laws of the state of its creation, a different situation might be presented. But this was not done in the instant case. Calling the distribution of corporate assets a distribution of depletion reserve does not make it a payment of capital instead of income when there are net earnings or accumulated surplus sufficient to meet it. And in my judgment, the act is correctly interpreted in paragraph 26 of Regulation 33 of the Treasury, issued thereunder in January, 1918, reading as follows:

"Dividend from depletion reserve. A reserve set up out of gross receipts and maintained by a corporation for the purpose of making good any loss or wasting of capital assets on account of depletion is not to be considered a part of the earned surplus of the company, but a reserve for the return or liquidation of capital. A dividend paid from such reserve will be considered a liquidating dividend and will not constitute taxable income to the stockholder except to the extent that the amount so received is in excess of the capital actually invested by the stockholder in the shares of stock held by him, and with respect to which the distribution was made. No dividend will, however, be deemed to have been paid from such reserve except to the extent that such dividend exceeds the surplus and undivided profits of the corporation at the time of such payment and unless the books, records, published statements, etc., of the corporation clearly indicate a corresponding reduction of capital assets resulting from such payment."

Inasmuch as the net earnings for 1917 were at the time of these distributions, as heretofore stated, more than sufficient to meet them, the claim for refund was properly rejected. A verdict for the defendant will, therefore, be directed.

Since this opinion was prepared, my attention has been called by the defendant's counsel to the opinion of Judge Cooper in Harder v. Irwin, not yet reported, an opinion in which I entirely concur.

JULIAN W. MACK,
U. S. Circuit Judge.

DECEMBER 18, 1922.

SCHEDULE I

Plaintiff's Exhibit D to opinion

[PHELPS DODGE CORPORATION. Memorandum re changes in financial condition 1912–1917]

	1912	1913	1914	1915	1916	1917	Total
Income, before deducting depletion		$11,120,368.73	$8,216,266.66	$10,501,310.77	$23,675,783.01	$22,456,906.32	$75,970,635.49
Depletion, at Treasury Department's rates		4,747,251.87	4,572,808.56	4,877,786.88	5,925,161.34	5,714,419.26	25,837,427.91
Profit		6,373,116.86	3,643,458.10	5,623,523.89	17,750,621.67	16,742,487.06	50,133,207.58
Dividends paid from earned surplus		7,425,000.00	6,300,000.00	9,000,000.00	14,625,000.00	10,800,000.00	48,150,000.00
Distributions of proceeds of depletion						3,600,000.00	3,600,000.00
Total distributions to stockholders		7,425,000.00	6,300,000.00	9,000,000.00	14,625,000.00	14,400,000.00	51,750,000.00
Capital expenditures:							
Mines		678,121.98	183,796.91	488,141.54	1,508,138.54	3,796,653.03	6,287,558.18
Plants		1,088,392.37	1,435,008.46	1,668,945.69	1,508,655.32	1,414,682.28	7,115,684.12
Investments		136,386.38	390,213.44	4,393.00	249,101.17	585,267.02	77,945.79
Total capital expenditures		1,903,200.73	860,998.11	2,152,694.23	2,767,692.69	5,796,602.33	13,481,188.09
Balance sheets, 31st December:							
Mines	$132,285,000.00	128,216,170.11	123,459,564.64	119,069,919.30	114,652,896.50	112,735,130.27	
Plants	5,281,367.23	5,911,154.45	8,233,318.46	9,440,549.51	10,455,211.45	11,484,535.18	
Investments	3,151,535.24	3,287,921.62	2,897,708.18	2,893,315.18	2,644,214.01	3,129,481.03	
Current assets derived from depletion		4,068,829.89	8,825,435.36	13,265,080.70	17,632,103.50	15,949,869.73	
Current assets—other	12,557,704.22	10,739,647.48	6,131,155.01	1,521,840.85	3,931,901.75	8,359,798.06	
Total assets	153,275,606.69	152,223,723.55	149,567,181.65	146,190,705.54	149,316,327.21	151,658,814.27	
Capital stock	45,000,000.00	45,000,000.00	45,000,000.00	45,000,000.00	45,000,000.00	45,000,000.00	
Surplus:							
Prior to 1913	108,275,606.69	107,223,723.55	104,567,181.65	101,190,705.54	101,190,705.54	97,590,705.54	
Since 1912					3,125,621.67	9,068,108.73	
Total capital	153,275,606.69	152,223,723.55	149,567,181.65	146,190,705.54	149,316,327.21	151,658,814.27	

32q In United States District Court

Judgment

[Title omitted.]

The issues in this action having been regularly brought on for trial before honorable Julian W. Mack, United States Circuit judge, and a jury of one at a stated term of the United States District Court for the Southern District of New York, held on the 20th day of February, 1922, at the United States Courts and Post Office Building in the Borough of Manhattan, city, county, State and Southern District of New York, and plaintiffs having appeared herein by Douglas, Armitage & McCann, their attorneys, Matthew C. Fleming, Esq., of counsel, and defendant having appeared by William Hayward, United States attorney for the Southern District of New York, his attorney, Richard S. Holmes, special assistant United States attorney, of counsel, and the allegations and
32r proofs of the parties having been heard and considered, and at the close of the testimony for both sides the attorneys for the plaintiffs and the defendant having moved for the direction of a verdict, and the honorable court on the 18th day of December, 1922, having granted the motion in favor of the defendant and having directed a verdict in favor of said defendant and the verdict having been entered accordingly, and the costs of said defendant having been taxed in the sum of $21.15,

Now, on motion of William Hayward, United States attorney for the Southern District of New York, attorney for defendant, it is

Adjudged that the complaint herein be, and it hereby is, dismissed upon the merits and that defendant have and recover of the plaintiffs the sum of $21.15 his costs as taxed and that said defendant have execution against said plaintiffs therefor.

Judgment signed this 22nd day of December, 1922.

ALEX. GILCHRIST, JR., *Clerk.*

32s In United States District Court

Bill of exceptions

[Title omitted.]

Caption

Be it remembered that afterward, to wit, on the twenty-second day of December, in the year of our Lord, one thousand nine hundred and twenty-one, at a stated term of the said court, begun and holden in New York, in and for the Southern District of New York, before his honor, Julian W. Mack, circuit judge, the issue joined in the

above entitled cause between the said parties, came on to be tried before the said judge, and it was adjourned until the 20th day of February, 1922, and on the said day the parties aforesaid by their consent according to the statute made and in such cases provided, duly stipulated and agreed to try the said case by a jury of
32t one, which was thereupon duly empanelled and sworn. The plaintiffs being represented by Douglas, Armitage & McCann, by Matthew Corry Fleming, Esq., Archibald Douglas, Esq., Paul Armitage, Esq., Edward Holloway, Esq., of counsel, and the defendant by William Hayward, United States attorney, by Richard S. Holmes, Esq., ass't U. S. attorney; by James J. Cosgrove, special attorney, Bureau of Internal Revenue, and upon the trial of the issues, the said attorneys thereupon entered into the following stipulation for the purpose of this suit only, to wit:

Stipulation of facts

1. That either party may, upon any trial or hearing of this suit and upon any motion, appeal or other proceeding or hearing arising therefrom, cite or refer to any of the regulations issued by the Treasury Department. The dates affixed to such papers shall be deemed to be the dates on which they were officially promulgated.

2. That for the purposes of this suit they admit as facts the following statements, subject, however, to any objections by any party to the materiality and relevancy as evidence of any or either
33 of the facts so admitted. Subject to such objections, the said statements shall, upon any trial or hearing of this suit and upon any motion, appeal or other proceeding therein or arising therefrom, be used as competent proof of the facts stated, and with the same force and effect as if all the facts therein stated had been duly proved by competent evidence in accordance with the statutes in such case made and provided and with the rules and practice of the United States courts.

3. That any party to this suit may introduce any other or further evidence, oral or written, which he may deem material or relevant to any of the issues raised in this suit, subject to objections by the other parties as to the competency, relevancy, or materiality of such evidence, it being the intention that this stipulation shall in no way preclude any of the parties from offering any evidence which they may wish to offer upon any of the matters relevant to the issues in this suit.

4. That Archibald Douglas, George Notman, and Edmund Coffin, at all the times mentioned in the complaint, were and now are citizens of the United States and residents of the State of New York, and of the 14th, 1st, and 2nd United States internal revenue districts of the State of New York, respectfully.

5. That James Douglas, died on June 25, 1918, a resident of the Borough of the Bronx, county of Bronx, city of New York, and State and Southern District of New York.

6. That the last will and testament of said James Douglas and three codicils thereto were duly admitted to probate on
34 August 27, 1918, by the surrogate of Bronx County. That Archibald Douglas, George Notman, and Edmund Coffin were duly appointed executors thereof by the surrogate of the county of the Bronx, State of New York, on said 27th day of August, 1918, and have duly qualified and are now acting as such executors.

7. That the defendant, William H. Edwards, is a resident and inhabitant of the Borough of Manhattan, city, county, and State and Southern District of New York, and was from the 8th day of April, 1917, and at the time of the commencement of this action was the collector of the United States internal revenue for the second district of New York.

8. That on March 1, 1913, James Douglas was the owner and holder of 41,025 shares of capital stock of Phelps Dodge & Company, Inc., hereinafter described; that on July 2, 1913, he purchased 25 additional shares of such stock for the sum of $2,500; that on April 1, 1917, said James Douglas, pursuant to the transaction hereinafter set forth, exchanged said 41,050 shares of the capital stock of Phelps Dodge & Co., Inc., for 41,050 shares of the capital stock of Phelps Dodge Corporation, hereinafter more fully described; that at the time of his death on June 25, 1918, he was the owner and holder of said 41,050 shares of the capital stock of said Phelps Dodge Corporation, so received in exchange.

9. That on the 1st day of March, 1913, the said 41,050 shares of stock of Phelps Dodge & Company, Inc., so held by the said James Douglas were of the value of at least $8,717,812.50.

35 10. That the said Phelps Dodge & Company, Inc., was at all times hereinafter mentioned and prior to the 1st day of April, 1917, a corporation organized on the 14th day of December, 1908, and existing under the laws of the State of New York, with an authorized capital stock of $50,000,000, of which $45,000,000 was issued and outstanding, with a principal place of business at 99 John Street, in the Borough of Manhattan, city and State of New York.

11. That on and prior to the 13th day of March, 1917, Copper Queen Consolidated Mining Company was a corporation organized on the 10th day of August, 1885, and existing under the laws of the State of New York, with an authorized capital stock of $2,000,000, all of which was issued and outstanding on March 13, 1917.

12. That on and prior to the 31st day of March, 1917, Detroit Copper Mining Company of Arizona was a corporation organized on the 24th day of September, 1872, and existing under the laws of the State of Michigan, having an authorized capital stock of $1,000,000, all of which was issued and outstanding on March 31, 1917.

13. That on and prior to the 31st day of March, 1917, Moctezuma Copper Company was a corporation, organized on the 17th day of September, 1895, and existing under the laws of the State of West

Virginia, with an authorized capital stock of $3,000,000, of which $2,600,000 was then issued and outstanding on March 31, 1917.

14. That on and prior to the 31st day of March, 1917, Burro
36 Mountain Copper Company was a corporation organized on the 20th day of January, 1904, and existing under the laws of the State of New Mexico, with an authorized capital stock of $8,000,000, all of which was then issued and outstanding on March 31, 1917.

15. That on and prior to the 31st day of March, 1917, Stag Canon Fuel Company was a corporation organized on the 8th day of December, 1905, and existing under the law of the State of New Mexico, with an authorized capital stock of $3,000,000, all of which was then issued and outstanding on March 31, 1917.

16. That on and prior to the 31st day of March, 1917, Bunker Hill Mines Company was a corporation organized on the 3rd day of November, 1909, and existing under the law of the State of West Virginia, with an authorized capital stock of $1,000,000, of which $750,000 was then issued and outstanding on March 31, 1917.

17. That on and prior to the 31st day of March, 1917, Phelps Dodge Mercantile Company was a corporation organized on the 18th day of December, 1911, and existing under the law of the State of New York, with an authorized capital stock of $4,000,000, of which $2,000,000 was then issued and outstanding on March 31, 1917.

18. That on and prior to the 1st day of March, 1913, the said Phelps Dodge & Company, Inc., was the owner and holder of all the capital stock issued and outstanding of the Copper Queen Consolidated Mining Company, the Detroit Copper Mining Company of Arizona, Burro Mountain Copper Company, Stag Canon
37 Fuel Company, Moctezuma Copper Company, Bunker Hill Mines Company, and Phelps Dodge Mercantile Company, hereinafter known as subsidiaries.

19. That on the 13th day of March, 1917, the capital stock of Copper Queen Consolidated Mining Company was duly increased to the sum of $50,000,000, divided into 500,000 shares, with a par value of $100 per share, by certificate of increase filed in the office of the secretary of state of New York on the 13th day of March, 1917.

20. That on the 14th day of March, 1917, the Copper Queen Consolidated Mining Company, by order of the Supreme Court of the State of New York, duly made and entered on the 5th day of February, 1917, in the office of the clerk of the county of New York, changed its name to Phelps Dodge Corporation.

21. That on or about the 1st day of April, 1917, Phelps Dodge & Co., Inc., assigned and transferred the entire capital stock of Detroit Copper Mining Company of Arizona, Stag Canon Fuel Company, Burro Mountain Copper Company, Moctezuma Copper Company, and Phelps Dodge Mercantile Company to Phelps Dodge Corporation, and Phelps Dodge Corporation executed and delivered to Phelps

Dodge & Company, Inc., its evidence of indebtedness in the sum of $73,000,000.

22. That on or about the 1st day of April, 1917, Phelps Dodge & Company, Inc., assigned, transferred and set over all its remaining assets (exclusive of $2,000,000 capital stock of Phelps
38 Dodge Corporation and a sufficient sum to meet liabilities) for the sum of $1,450,000, and Phelps Dodge Corporation executed and delivered its evidence of indebtedness for the sum of $1,450,000 to Phelps Dodge & Company, Inc.

23. That on or about the 1st day of April, 1917, Phelps Dodge & Company, Inc., duly transferred, assigned and delivered to Phelps Dodge Corporation evidence of indebtedness of Phelps Dodge Corporation, amounting to the sum of $74,450,000, in exchange for $43,000,000 of the capital stock of Phelps Dodge Corporation.

24. That on or about the 1st day of April, 1917, Phelps Dodge & Company, Inc., duly dissolved and distributed to its shareholders in liquidation its sole assets, consisting of $45,000,000 of capital stock of Phelps Dodge Corporation, share for share, in exchange for its outstanding capital stock of $45,000,000.

25. That on or about the 10th day of April, 1917, Detroit Copper Mining Company of Arizona, Burro Mountain Copper Company, and Stag Canon Fuel Company transferred, assigned, and set over in liquidation to its stockholder, the Phelps Dodge Corporation, all of its property and assets, and its stockholder, Phelps Dodge Corporation, in exchange therefor transferred to each of the said companies all of its issued and outstanding capital stock.

26. That subsequent to the 1st day of March, 1913, and prior to the 1st day of April, 1917, the Copper Queen Consolidated Mining Company, the Detroit Copper Mining Company of Arizona, Burro
39 Mountain Copper Company, Stag Canon Fuel Company, Moctezuma Copper Company, Bunker Hill Mines Company, and subsequent to the 31st day of March, 1917, and prior to the 28th day of December, 1917, the Phelps Dodge Corporation, Moctezuma Copper Company, and Bunker Hill Mines Company mined and extracted copper ore from the mines and the ore bodies that were known probable or prospective ore, as of February 28, 1913, and sold copper and copper ore so produced.

27. That for a long time prior to the 1st day of March, 1913, the Copper Queen Consolidated Mining Company, the Detroit Mining Company of Arizona, Burro Mountain Copper Company, Stag Canon Fuel Company, and Moctezuma Copper Company were the owners and holders and operators in their own names of various valuable copper mines containing copper ore.

28. That the Commissioner of Internal Revenue, on December 1, 1919, made a provisional valuation, for depletion and other purposes, as shown by Exhibit A, attached hereto, of the various mining

properties owned by the said subsidiaries of Phelps Dodge Corporation, Inc., as of March 1, 1913, as follows:

Cooper Queen limestone (copper)	$65, 369, 000
Copper Queen porphyry mines (copper)	15, 355, 000
Moctezuma mines (copper)	25, 260, 000
Burro Mountain mines (copper)	6, 269, 000
Morenci mines (copper)	8, 832, 000
Total value copper mines, March 1, 1913	121, 085, 000
Value of Stag Canon coal mines	11, 200, 000
Total value fixed by bureau as of March 1, 1913, all company's mines	132, 285, 000

That upon the basis of the above valuation the income and excess profits tax returns of Phelps Dodge Corporation, for the year 1917 and 1918, were audited and closed by the Commissioner of Internal Revenue and the tax paid.

29. That in the years 1913 to 1917, inclusive, there was mined from the above mentioned mines copper ore and coal which the said Copper Queen Consolidated Mining Company, the Detroit Copper Mining Company of Arizona, Burro Mountain Copper Company, Stag Canon Fuel Company, and Moctezuma Copper Company owned in March 1, 1913, from which were produced the following (copper is given in pounds; coal in tons):

	Copper Queen Mining Co.	(Morenci) Detroit Copper Mining Co.	Burro Mountain Mining Co.
1913	85, 394, 828	24, 931, 426	
1914	76, 842, 973	20, 265, 994	
1915	86, 912, 528	15, 321, 867	
1916	95, 397, 219	17, 585, 608	6, 974, 965
1917	89, 315, 717	13, 195, 495	13, 107, 754
Total	433, 863, 265	91, 300, 390	20, 075, 719

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	Moctezuma Mines Company	Stag Canon Fuel Co. (Coal)
1913	36, 598, 132	1, 322, 813
1914	21, 621, 566	1, 355, 338
1915	23, 104, 609	1, 265, 674
1916	36, 254, 493	1, 439, 904
1917	36, 712, 433	1, 406, 079
Total	154, 291, 233	6, 789, 808

30. That based on the above provisional valuation and the above tonnage of copper and coal extracted during the years 1913 and 1917, the Commissioner of Internal Revenue fixed the depletion of the said several companies for the years 1913 to 1917, inclusive,

and the amount of depletion so fixed and the amount set up on the books of said companies are as follows:

COPPER QUEEN MINING COMPANY (DEPLETION)

	As per books	As fixed by Treasury Department
1913	$524, 469. 20	$2, 924, 762. 89
1914	411, 270. 35	3, 158, 244. 55
1915	534, 563. 79	3, 572, 144. 82
1916	3, 382, 246. 75	3, 920, 825. 70
1917	3, 065, 500. 20	3, 670, 875. 97
Total	7, 948, 050. 29	17, 246, 853. 93

DETROIT COPPER MINING COMPANY (MORENCI)

1913	$108, 321. 47	$644, 061. 89
1914	86, 652. 65	628, 245. 81
1915	87, 411. 33	474, 977. 88
1916	409, 407. 00	545, 153. 85
1917	290, 817. 51	409, 060. 34
Total	982, 609. 95	2, 701, 499. 77

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BURRO MOUNTAIN COPPER COMPANY

1913		
1914		
1915		
1916		
1917		$184, 139. 08
	$476, 075. 00	346, 044. 70
Total	476, 075. 00	530, 183. 78

MOCTEZUMA COPPER COMPANY

1913	$164, 654. 80	$1, 009, 498. 53
1914	122, 301. 14	715, 673. 83
1915	125, 699. 80	764, 762. 56
1916	2, 715, 289. 00	1, 200, 023. 72
1917	1, 613, 830. 00	1, 215, 181. 53
Total	4, 741, 774. 74	4, 905, 140. 17

STAG CANON FUEL COMPANY

1913	$56, 204. 10	$68, 918. 56
1914	36, 610. 32	70, 644. 37
1915	33, 160. 32	65, 941. 62
1916	71, 995. 20	75, 018. 99
1917	70, 303. 96	73, 256. 72
Total	268, 273. 90	353, 780. 26

TOTAL AS TO YEARS

	As per books	As fixed by Treasury Department
1913	$853, 649. 57	$4, 747, 251. 87
1914	686, 834. 45	4, 572, 808. 56
1915	780, 835. 24	4, 877, 786. 88
1916	6, 578, 937. 95	5, 925, 161. 34
1917	5, 516, 526. 67	5, 714, 419. 26
	14, 416, 783. 88	25, 837, 427. 91

43 31. That the above amounts were reached by multiplying the number of units of copper and coal extracted in each of the above years by the unit depletion values fixed by the Bureau of Internal Revenue in accordance with the above valuations as of March 1, 1913, and that in adjusting income and excess profits taxes of the company for the years 1913–1918 the above depletion allowances were used as factors by the Bureau of Internal Revenue. That the 1917 income and excess profits taxes of the company were finally determined on or about March 1, 1920.

32. That on September 13, 1917, at a meeting of the board of directors of Phelps Dodge Corporation, the following preamble and resolution was adopted:

"Whereas, this company in accordance with the income tax section of the tariff act of 1913 and with the income tax law of September 8, 1916, has yearly, in computing its income, deducted therefrom a reasonable allowance for depletion of its mines, based upon the fair market value thereof as of March 1, 1913; and

"Whereas, the income tax and the ruling of the Department of Internal Revenue provide for a separation of said deductions from income and provide further that payments to stockholders from said depletion account will be a return of capital invested, and are not subject to income tax in the hands of the shareholders:

"Therefore, resolved, That this company distribute among
44 its stockholders from said depletion account, three dollars a share, to be paid on September 28, 1917, to stockholders of record on September 24, 1917, the total amount so paid to be deducted from said depletion account."

33. That the distributions so authorized were duly paid to the stockholders of record of Phelps Dodge Corporation, and that on September 28, 1917, James Douglas received $123,150 as his proportionate share in such distribution.

34. That the directors of Phelps Dodge Corporation, at a meeting held on December 13, 1917, adopted the following preambles and resolutions:

"Whereas this company in accordance with the income tax section of the tariff act of 1913, and with the income tax law of September 8, 1916, has yearly, in computing its income, deducted therefrom a reasonable allowance for depletion of its mines, based upon the fair market value thereof as of March 1, 1913; and

"Whereas the income tax law and the rulings of the Department of Internal Revenue provide for a separation of said deductions

from income and provide further that payments to stockholders from said depletion account will be a return of capital invested and are not subject to income tax in the hands of the shareholders:

"Therefore, resolved, That this company distribute among its stockholders from said depletion account five dollars per share,
45 to be paid on December 28, 1917, to stockholders of record on December 18, 1917, the total amount so paid to be deducted from said depletion account."

35. That hereafter the distribution so authorized was paid to the stockholders of record of Phelps Dodge Corporation, and James Douglas received on December 28, 1917, $205,250, as his proportionate share of such distribution.

35A. That after the declaration of the depletion dividends in question there was no reduction of the share of capital stock of Phelps Dodge Corporation.

36. That during the calendar years 1913 to 1916, inclusive, the net income of Phelps Dodge & Co., Inc., before deducting depletion, was as follows:

1913	$11, 120, 368. 73
1914	8, 216, 266. 66
1915	10, 501, 310. 77
1916	23, 675, 783. 01
That during the year 1917 the net income of Phelps Dodge Corporation, before deducting depletion, was as follows:	
1917	22, 456, 906. 32
	75, 970, 635. 49

37. That the said net income for each company for each year could not be determined definitely until after the end of each year.

38. That during the calendar years 1913 to 1916, inclusive, Phelps Dodge & Co., Inc., distributed the following amounts to its stockholders:

46 1913	$7, 425, 000
1914	6, 300, 000
1915	9, 000, 000
1916	14, 625, 000
1917 (Phelps Dodge Corporation)	14, 400, 000
	51, 750, 000

Dividends paid by subsidiary companies to Phelps Dodge & Co., Inc., and Phelps Dodge Corporation, 1909 to 1917, inclusive

TO PHELPS DODGE & CO., INC.

Year	Copper Queen Mining Co.	Detroit Copper Mining Company	Stag Canon Fuel Co.
1909	$4, 021, 354. 50	$760, 000. 00	
1910	6, 299, 815. 00	1, 840, 000. 00	$180, 000. 00
1911	5, 200, 000. 00	800, 000. 00	240, 000. 00
1912	5, 707, 351. 23	1, 464, 610. 45	414, 926. 96
1913	5, 700, 000. 00	780, 000. 00	180, 000. 00
1914	4, 500, 000. 00	280, 000. 00	
1915	7, 000, 000. 00	920, 000. 00	
1916	14, 000, 000. 00	1, 000, 000. 00	120, 000. 00
	52, 428, 520. 73	7, 844, 610. 25	1, 134, 926. 96

Dividends paid by subsidiary companies to Phelps Dodge & Co., Inc., and Phelps Dodge Corporation, 1907 to 1917, inclusive—Continued

TO PHELPS DODGE & CO., INC.—Continued

Year	Moctezuma Copper Co.	Mercantile	Totals
1909	$988, 000. 00		$5, 769, 354. 50
1910	468, 000. 00		8, 787, 815. 00
1911	754, 000. 00		6, 994, 000. 00
1912	2, 118, 569. 58	$300, 000. 00	10, 005, 458. 02
1913	1, 950, 000. 00	500, 000. 00	9, 110, 000. 00
1914	1, 170, 000. 00	400, 000. 00	6, 350, 000. 00
1915	1, 534, 000. 00	500, 000. 00	9, 954, 000. 00
1916	3, 380, 000. 00	600, 000. 00	19, 100, 000. 00
	12, 362, 569. 58	2, 300, 000. 00	76, 070, 627. 52

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TO PHELPS DODGE CORPORATION

Year	Moctezuma Copper Co.	Mercantile	Totals
1917	$1, 950, 000. 00	$500, 000. 00	$2, 450, 000. 00

9 YEARS

Copper Queen Mining Co	$52, 428, 520. 73
Detroit Copper Mining Co	7, 844, 610. 25
Stag Canon Fuel Co	1, 134, 926. 96
Moctezuma Copper Co	14, 312, 569. 58
Mercantile	2, 800, 000. 00
Totals	78, 520, 627. 52

39. That during the calendar year 1917 the following amounts were distributed to stockholders:

PHELPS DODGE & CO., INC.

Div., 2½%	$1, 125, 000	
Paid Mar. 29, 1917, extra, 3½%	1, 575, 000	
		$2, 700, 000

PHELPS DODGE CORPORATION

Div., 2½%	$1, 125, 000	
Paid June 28, 1917, extra, 5½%	2, 475, 000	
		3, 600, 000
Div., 2½%	1, 125, 000	
Paid Sept. 28, 1917, extra, 2½%	1, 125, 000	
Res. for D., 3%	1, 350, 000	
		3, 600, 000
Div., 2½%	1, 125, 000	
Paid Dec. 28, 1917, extra, 2½%	1, 125, 000	
Res. for D., 5%	2, 250, 000	
		4, 500, 000
		14, 400, 000

the 8100000 includes all but X

39A. It is stipulated that the invested capital (as defined in section 207 of the revenue act of 1917) of the Phelps Dodge Corporation was not reduced in the excess profits tax return filed by the said company by the amount of any of the dividends declared and paid in 1917, as above set forth. Attached here as Exhibit R
48 is a copy of the annual report of the Phelps Dodge Corporation for the year 1917, as issued to its stockholders.

40. That Phelps Dodge Corporation as of April 2, 1917, took over and set up on its books certain "depletion reserve" account which were on the books of the following corporations: Copper Queen Consolidated Mining Company (Morenci Branch), Burro Mountain Mining Company, Stag Canon Fuel Company (Dawson Fuel Company), all of the capital stock of which was owned by Phelps Dodge & Company, Inc. The Moctezuma Copper Company, a subsidiary company of the Phelps Dodge Corporation, set up on its books a "depletion reserve" account. These accounts represented the depletion which had been set up on the books of the several companies for ores extracted prior to the first day of April, 1917 (Exhibits K, M, & P).

In addition to the above, additional accounts captioned "ore reserves," representing a so-called "realized depletion," were set up on the books of the above companies as per Exhibits L & Q.

On September 13, 1917, a dividend was declared of $1,350,000, payable September 28, 1917.

On December 13, 1917, a dividend was declared of $2,250,000, payable December 28, 1917.

Phelps Dodge Corporation set up on its books as of September 26, 1917, an account payable entitled "distribution from reserve for depletion," which was credited with these dividends as of the dates payable, and in addition to the aforesaid depletion reserve accounts, which had been set up a record of the annual depletion
49 sustained, an additional account entitled "Reserve for depletion" was opened, which was debited with the dividends of September, 1917, and December, 1917, and said account entitled "Reserve for depletion" has not been closed (Exhibit J).

These dividends have not been charged to the first mentioned "depletion reserve" account or "ore reserve account" set up on the books as of April, 1917 (Exhibits K, L, M, P, and Q).

That when said distributions were paid in cash the amount was credited to the "Cash account" on the books of said Phelps Dodge Corporation and debited to the said account entitled "Distribution from reserve for depletion."

41. That for the purpose of this action, it is stipulated that the value of the assets transferred to Phelps Dodge & Co., Inc., in December, 1908, was approximately $90,000,000 net.

That for these assets $45,000,000 of the capital stock of the corporation was issued and that the value to the said corporation of said assets was $90,000,000 of which $66,000,000 was the value of the mines.

42. That there had been no resolution of the board of directors specifically distributing capital, either by dividends or otherwise, of Phelps Dodge Corporation or Phelps Dodge & Co., Inc., or any of their subsidiaries prior to 1917.

43. That of the above distribution in 1917 by Phelps Dodge Corporation to its stockholders, the only amount specifically declared to be a distribution of the depletion account was the $3,600,000 purporting to be paid from depletion reserve in the year 1917 as set up on the books of the company.

50 44. That on March 28, 1918, James Douglas duly filed his income tax return with the defendant, to which return a statement was attached as follows:

"NOTE.—In addition to the monies received during the year 1917 as reported in the foregoing individual income tax return for 1917, I have received the following amounts:

1917		
Sept. 28.	Rec'd as a stockholder from the Phelps Dodge Corporation, 99 John Street, New York, N. Y., a distribution from reserve from depletion	$123,150
Dec. 28.	Do	205,250
	Total	328,400"

45. That at all times hereinafter mentioned the Phelps Dodge Corporation was and is a going concern.

46. That on an audit of the tax return for the year 1917, filed by James Douglas, his executors, the plaintiffs herein, were duly notified by the Commissioner of Internal Revenue on February 20, 1919, that the amount of $329,605 of which sum the said $328,400 formed a part, was income for the year 1917 and included in the said income were the two dividends so paid by the said Phelps Dodge Corporation, and that such dividends were taxable as income, and that thereupon a tax of $173,579.72 based on such claim of

51 additional income was assessed against plaintiffs. That plaintiffs were notified by defendant that failure to pay the said sum would cause a 5 per cent penalty to accrue, together with interest at 1 per cent per month from the date the defendant claimed such tax due until paid.

47. That plaintiffs duly paid a tax on May 16, 1919, of $173,579.72 so claimed by defendant to be due, which payment was made under written protest and to avoid threatened penalties.

48. That on November 24, 1919, plaintiffs filed a written claim for refund of the sum of $173,579.72 so paid on form 46, with the Commissioner of Internal Revenue, demanding the refunding of the said sum as a tax illegally and improperly assessed and collected.

49. That said claim for refund was rejected in writing by the Commissioner of Internal Revenue on the 19th day of April, 1920, and no part of the said sum of $173,579.72 has been refunded or repaid.

50. That Exhibit A is a copy of a statement fixing the provisional valuation of the mines of the Phelps Dodge Corporation and its

subsidiaries as of 1917, together with depletion statement signed by J. C. Dick, head of the mines valuation section, and L. C. Graton, valuation engineer of the Bureau of Internal Revenue, Treasury Department, dated December 1, 1919; and it is further stipulated that the same is a true copy of the original signed statement.

51. It is further stipulated that Exhibits A to R, inclusive, are true and correct copies of documents relative to this action,
51a and are admitted as exhibits herein, subject to paragraphs 1, 2, and 3.

52. It is further stipulated that the exhibits attached to the complaint as filed in this action, are true and correct copies of the original documents and are hereby made a part of this stipulation.

The attorneys for the plaintiffs offered in evidence the following papers and exhibits:

1. The income and excess profits tax return of the Phelps Dodge Corporation for the year 1917 (plaintiffs' Exhibit S).

2. A "Memorandum from the files" which was handed to Matthew C. Fleming, Esq., on January 27, 1922, by the head of the division of natural resources of the Bureau of Internal Revenue, which was used as one of the bases of calculating the Phelps Dodge Corporation tax (plaintiff's Exhibit T).

3. A letter from the Treasury Department, signed by Mr. Newton, acting assistant to the commissioner, dated March 2, 1920, fixing the income and the invested capital of the Phelps Dodge Corporation for the year 1917 (plaintiffs' Exhibit U).

4. A letter from the Deputy Commissioner of Internal Revenue, dated July 14, 1917, to the effect that distribution of depletion reserve is a return of capital and not taxable. Whereupon
51b counsel for the defendant did then and there insist before said judge that the said exhibit should not be allowed on the ground that the same was not material or relevant or competent, and prayed the said court not to admit and allow the same, and the said judge did then and there refuse to allow and admit the said exhibit to be introduced; whereupon counsel for said plaintiffs did then and there propose the exception to the ruling of said court, and prayed that this bill of exception might be sealed and it is hereby sealed accordingly.

JULIAN W. MACK. (L. S.)

Statement re offers in evidence

5. A statement of the separate earnings and depletion and dividends of the Copper Queen Consolidated Mining Company for the years 1913 to 1916, inclusive (plaintiffs' Exhibit V).

6. A letter from the Acting Commissioner of Internal Revenue addressed to Matthew C. Fleming, esq., as counsel for Phelps Dodge Corporation, on May 3, 1921 (plaintiffs' Exhibit W).

7. Two notices sent to stockholders accompanying September and December distribution of depletion reserve (plaintiffs' Exhibits X and Y).

8. Checks of Phelps Dodge Corporation to the order of James Douglas, being two checks dated September 28, 1917, one marked "Dividend No. 2 and extra" and the other "Distribution
51c from reserve for depletion" and two checks dated December 28, 1917, one of them marked "Dividend No. 3 and extra" and the other "Distribution No. 2 from reserve for depletion" (plaintiffs' Exhibit Z).

9. A memorandum showing how the depletion reserve amount which appears on page 8 of the company's annual report for the year 1917, being plaintiffs' Exhibit R, appears as $41,657,487.95 after deducting $3,600,000 distributed to the stockholders from depletion reserve (plaintiffs' Exhibit A 1).

10. Letter of the solicitor of internal revenue giving the ground on which the claim was rejected (plaintiffs' Exhibit A 2).

It was thereupon stipulated by the attorneys that either party may refer to any Treasury decision or to any regulation or to any ruling of the Commissioner of Internal Revenue approved by the Secretary of the Treasury.

It was thereupon conceded by the attorneys for the respective parties that the fiscal year of Phelps Dodge Corporation was the calendar year, for the years in question and thereupon plaintiffs rested their case.

Thereupon the attorneys for the said defendant, William H. Edwards, collector of internal revenue for the second district, New York, offered in evidence the following papers:

1. Certified photostatic copy of the return of Dr. James Douglas, with the exhibits annexed thereto (defendant's Exhibit No. 1).

51d 2. Certified photostatic copy of the claim for refund filed by the plaintiffs in this case for the taxes involved (defendant's Exhibit No. 2) and thereupon said defendant rested his case.

Motions for directed verdict

Thereupon plaintiffs formally moved for a direction of a verdict in their favor, upon which motion the court reserved decision.

Thereupon the defendant moved for the direction of a verdict, upon which the court reserved decision.

Thereafter and on the 18th day of December, 1922, the said Hon. Julian W. Mack, judge, directed a verdict in favor of the defendant and refused to direct a verdict in favor of the plaintiffs. The counsel for the plaintiffs did then and there except to the direction of a verdict for the said defendant, and prayed that their bill of exceptions be allowed and might be sealed and it is sealed accordingly.

JULIAN W. MACK. (L. S.)

And thereupon the counsel for the said plaintiffs then and there did except to the refusal of the said court to a direction of the

verdict in favor of the plaintiffs and prayed that their exceptions be allowed and might be sealed and it is hereby sealed accordingly.

JULIAN W. MACK. (L. S.)

Verdict

Thereupon the jury rendered a verdict in favor of the defendant. The foregoing bill of exceptions contains all of the evidence received upon the trial of this action, relating to the foregoing exceptions.

52 *Order settling bill of exceptions*

The attorneys for the plaintiffs in error and the plaintiffs above having thereupon tendered this as the plaintiffs' bill of exceptions to the rulings of the court upon the trial of this action, and having requested that the signature and seal of the trial judge aforesaid should be annexed to the same pursuant to that statute in such cases made and provided: and for as much as none of such matters and exceptions so offered and made to the ruling and direction of said judge, and none of the evidence and other things do appear upon the record of the said case, the said judge, pursuant to said request, did put his signature and seal to this bill of exceptions this 16th day of May, 1923.

[SEAL OF THE COURT.] JULIAN W. MACK,
Trial Judge.

PLAINTIFFS' EXHIBIT A

PHELPS DODGE CORPORATION 1917 TAXES VALUATIONS

Fair market values of company's mines have been approximated separately, viz:

Copper Queen lime deposit	$65,369,000.00
Copper Queen porphyry	15,355,000.00
Moctezuma	25,260,000.00
Burro Mountain	6,269,000.00
Morenci	8,832,000.00
Total	121,085,000.00
53 To this I have added the company's figures as fair market value of Stag Canon property	11,200,000.00
Total value of deposits exclusive of plant and equipment	132,285,000.00

Depletion

Provisional depletion for 1917 by unit method, $5,714,420.26.

As to the value of the deposits in the year 1908, it might be fair to assume that the properties would measure up in 1908 about as well as in 1913, and that from this total valuation of $132,285,000

by deducting the Copper Queen porphyry deposit of which little was known at that time, and also the Burro Mountain deposit would leave the probable value of the deposits in 1908 in the neighborhood of $110,000,000.00.

(Signed) J. C. DICK,
Head Metals Valuation Section.
(Signed) L. C. GRATON,
Valuation Engineer.

DEC. 1, 1919.

54 PLAINTIFFS' EXHIBIT B

Reserves for depletion, per books, 1920

[Phelps Dodge Corporation, combined]

	Stag	Copper Queen	Morenci	Burro	Total P. D. Co.	Moctezuma	Total combined
1913	56, 204. 10	824, 469. 20	108, 321. 47			164, 654. 80	853, 649. 57
1914	36, 610. 32	441, 270. 35	86, 652. 64			122, 301. 14	686, 834. 45
1915	33, 160. 66	534, 563. 79	87, 411. 33			125, 699. 80	780, 835. 58
1916	71, 995. 20	3, 362, 246. 75	409, 407. 00			2, 715, 280. 00	6, 578, 937. 95
1917	70, 303. 96	3, 065, 500. 20	290, 817. 51	476, 075. 00		1, 613, 830. 00	5, 516, 526. 67
1918	66, 780. 49	3, 005, 610. 30	417, 979. 32	582, 981. 00	4, 073, 351. 11	1, 589, 462. 00	5, 662, 813. 11
1919	44, 679. 24	2, 373, 216. 22	354, 323. 83	149, 657. 98	2, 921, 877. 27	876, 471. 22	3, 798, 348. 49
	379, 733. 97	13, 326, 876. 81	1, 754, 913. 10	1, 208, 713. 98	16, 670, 237. 86	7, 207, 707. 96	23, 877, 945. 82
1920	58, 056. 58	2, 657, 675. 44		174, 313. 68	2, 890, 045. 70	776, 198. 84	3, 666, 244. 54
	437, 790. 55	15, 984, 552. 25	1, 754, 913. 10	1, 383, 027. 66	19, 560, 283. 56	7, 983, 906. 80	27, 544, 190. 36
						Ore reserves	
		22, 964, 685. 91	2, 905, 368. 56		25, 870, 054. 47	4, 970, 649. 26	30, 840, 703. 73

55 PLAINTIFFS' EXHIBIT C

Re depletion

[Phelps Dodge Corporation, Combined]

	Treasury Department's valuations as of 1st Mar., 1913	Rate for depletion per lb. copper
Copper Queen:		
Limestone	$65, 369, 000. 00	0. 0411
Porphyry	15, 355, 000. 00	. 0229
Moctezuma	25, 260, 000. 00	. 0331
Burro Mountain	6, 269, 000. 00	. 0310
Morenci	8, 832, 000. 00	. 0264
Total copper properties	121, 085, 000. 00	
Stag Canon coal properties	11, 200, 000. 00	. 0521
	132, 285, 000. 00	

Re depletion—Continued

	Depletion	
	At department's rates	Per books
1913 (10 mos.)	$4, 747, 251. 87	$853, 649. 57
1914	4, 572, 808. 56	686, 834. 45
1915	4, 877, 786. 88	780, 835. 58
1916	5, 925, 161. 34	6, 578, 937. 95
1917	5, 714, 419. 26	5, 516, 526. 67
	25, 837, 427. 91	14, 416, 784. 22
1918	6, 196, 230. 63	5, 662, 813. 11
1919	3, 800, 225. 03	3, 798, 348. 49
	35, 833, 883. 57	23, 877, 945. 82
1920	3, 666, 244. 54	3, 666, 244. 54

56 PLAINTIFF'S EXHIBIT D

Phelps Dodge Corporation. Memorandum re changes in financial condition—1912–1917. [Omitted. Printed side page 32p, ante.]

57 PLAINTIFF'S EXHIBIT E

Phelps Dodge Corporation (Copper Queen, Burro Mountain, and Morenci Branches)—copper sales, 1917

	Deliveries of copper, in pounds	Gross amount received therefore, dollars
January	13, 272, 862	3, 507, 844. 47
February	18, 023, 748	4, 755, 572. 92
March	7, 282, 629	2, 009, 219. 65
April	18, 265, 849	4, 936, 031. 10
May	18, 003, 910	4, 959, 536. 73
June	14, 853, 376	4, 008, 460. 65
July	16, 031, 508	4, 425, 617. 10
August	14, 620, 334	4, 056, 514. 79
September	14, 247, 135	3, 929, 826. 67
October	13, 043, 543	3, 372, 929. 41
November	14, 381, 937	3, 586, 916. 04
December	10, 759, 259	2, 638, 576. 70
Total	172, 796, 090	46, 187, 046. 23

58 PLAINTIFF'S EXHIBIT F

Phelps Dodge Corporation—Condensed summary of combined costs of copper sold, year 1917

	Amount	Average per pound copper sold.
Mining, treating and refining charges	$21, 545, 456. 51	$0. 1247
Less silver and gold saving	2, 791, 725. 33	. 0162
	18, 753, 731. 18	. 1085
Add:		
Depreciation of plants, etc	1, 097, 431. 77	. 0064
General expenses	796, 633. 71	. 0046
Taxes	5, 857, 595. 21	. 0339
Depletion of mines	5, 516, 526. 67	. 0319
Total combined costs	32, 021, 918. 54	. 1853
Less:		
Profit on operations of coal and mercantile departments	1, 674, 525. 01	
Miscellaneous earnings	498, 899. 32	
	2, 173, 424. 33	. 0126
Cost of copper sold, year 1917	29, 848, 494. 21	. 1727

February 7, 1922.

59 PLAINTIFF'S EXHIBIT G

Phelps, Dodge & Co.—Balance sheet, December 31, 1916 (including assets and liabilities of subsidiary companies owned)

ASSETS

Fixed:			
Mines and mining claims, coal mines, etc	$34, 578, 682. 43		
Less reserve for depletion of ore and coal	8, 409, 548. 95	$26, 169, 133. 48	
Buildings and machinery at mines, reduction works, miscellaneous buildings, ranches, etc	14, 360, 059. 32		
Less reserve for depreciation	3, 904, 847. 87	10, 455, 211. 45	
Investments in sundry companies		2, 644, 214. 01	$39, 268, 558. 94
Deferred:			
Expenditures in suspense and paid in advance		560, 301. 62	
Materials and supplies for use in future operations		2, 202, 912. 10	2, 763, 213. 72

Current:		
Merchandise held for sale	$1,648,355.24	
Metals in process and on hand—copper at cost; silver and gold at market	7,993,924.24	
Accounts receivable	4,031,300.34	
Marketable securities	3,062,031.50	
Cash	7,746,519.71	
		$24,482,131.03
		66,513,903.69

LIABILITIES

Capital stock:		
Authorized issue—500,000 shares of $100.00 each, of which there have been issued 450,000 shares		$45,000,000.00
Current:		
Taxes accrued	$1,471,131.22	
Accounts payable	3,830,596.83	
Wages payable	525,049.22	
		5,826,777.27
Surplus:		
Balance December 31, 1915	8,337,863.75	
Earnings for year ending December 31, 1916 $24,030,904.69		
Less depletion of ore and depreciation on plants 2,056,642.02		
	21,974,262.67	
	30,312,126.42	
Deduct dividends paid	14,625,000.00	
		15,687,126.42
		66,513,903.69

60 PLAINTIFF'S EXHIBIT H

Extract from photostat of page 87 of ledger:

3	Surplus account	$2,250,000	
56	To dividend No. 2 and extra. For dividend payable this day as follows:		
	Regular, 450,000 shares @ $2½	1,125,000	
	Extra, 450,000 shares @ $2½	1,125,000	
			$2,250,000
58	Reserve for depletion	1,350,000	
	To distribution from reserve for depletion No. 1		1,350,000
	For amount distributed this day from reserve for depletion to stockholders as a return of capital invested; say, 450,000 shares © $3.00 per sh	1,350,000	

PLAINTIFF'S EXHIBIT I

Extract from photostat of page 123 of ledger:

58	Reserve for depletion	$2,250,000	
58	To distribution from reserve for depletion No. 2		2,250,000
	For amount distributed this day from reserve for depletion to stockholders as a return of capital invested: say, 450,000 shares @ $5.00 per share		

Photostat of page 58 of ledger:

DISTRIBUTION FROM RESERVE FOR DEPLETION #1

1917						1917			
Dec. 31.	125	To First N. Bk. Spec. a/c		1,347,750		Sept. 26.	87	By Res. for depletion	1,350,000
"		" balance		2,250					1,350,000
					1,350,200				
1918						1917			
June 28.	208	To First N. B. Spec. a/c 2/26		459		Dec. 31.		By balance	2,250
"	"	" Do.	6/25	1,041					
Nov. 30.	30	" Do.	9/27	447					
Dec. 31.	55	" Do.		3					
"		" balance		300					
					2,250				2,250
1919						1918			
Oct. 8.	155	To First N. Bk. Spec. a/c 3/25		300		Dec. 31.		By balance	300

DISTRIBUTION FROM RESERVE FOR DEPLETION #2

1918						1917			
June 28.	208	To First N. B. Spec. a/c 3/26		2,246,565		Dec. 28.	125	By res. for deplet.	2,250,000
"	"	" Do.	6/25	1,735					
Nov. 30.	30	" Do.	9/27	745					
Dec. 31.	55	" Do.		955					
					2,250,000				2,250,000

62

DISTRIBUTION FROM RESERVE FOR DEPLETION #3

1918						1918			
Nov. 30.	30	To First N. B. Spec. a/c 9/27		898,874		June 28.	208	By res. for deplet.	900,000
Dec. 31.	55	" Do.		106					
31.		" balance		1,020					
					900,000				900,000
1919						1918			
Oct. 8.	185	To First N. Bk. Spec. a/c 3/28		40		Dec. 31.		By balance	1,020
"	156	" Do.	6/30	500					
Dec. 31.	219	" Do.		380					
"		" balance		100					
					1,020				1,020
						1919			
						Dec. 31.		By ledger No. 2	100

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DISTRIBUTION FROM RESERVE FOR DEPLETION #4

1918						1918			
Sept. 30.	4	To U. S. of A. 10/25 y. C. 4¼% B.	891,300			Sept. 30.	4	By res. for deplet.	900,000	
Dec. 31.	55	To First N. Bk. Spec. a/c	8,558							
"		" balance	142							
				900,000						900,000
1919						1918			
Oct. 8.	185	To 1st N. Bk. Spec. a/c 3/28	112			Dec. 31.		By balance	142	
Dec. 31.	219	" Do.	30							
				142						142

DISTRIBUTION NO. 5 FROM RESERVE FOR DEPLETION

1919						1918			
Jan. 2.	93	To U. S. of Amer. 4¼ % bond	891,200			Dec. 31.	42	By res. for depletion	900,000	
Oct. 8.	185	To 1st N. Bk. Spec. a/c 3/28	8,678							
"	186	" Do 6/30	92							
Dec. 31.	219	" Do	30							
				900,000						900,000

RESERVE FOR DEPLETION

1917						1917			
Sept. 26.	84	To dist. from res. for D. #1	1,350,000			Dec. 31.		By balance	3,000,000	
Dec. 28.	120	" Do #2	2,250,000							
				3,600,000						3,600,000
1917						1918			
Dec. 31.		To balance	3,600,000			Dec. 31.		By balance	6,300,000	
1918										6,300,000
June 28.	208	" Dist. #3 from res. for D.	900,000							
Sept 30.	4	" " #4 " " " "	900,000							
Dec. 31.	42	" " #5 " " " "	900,000							
				6,300,000						
1918						1919			
Dec. 31.		To balance	6,300,000			Dec. 31.		By ledger #2	6,300,000	
1919										
Dec. 31.		To ledger #2	6,300,000							

PLAINTIFF'S EXHIBIT K

Photostat of page 9 of ledger:

DEPLETION RESERVE

		Copper Queen					
1919 Dec. 31.	To balance	13,326,876.81		1917 April 2.	8 By sundries	4,882,550.09	
				Dec. 31.	24 " mine deple.	3,065,500.20	
				1918 Dec. 31.	82 " " "	3,005,610.30	
				1919 Dec. 31.	244 " " "	2,373,216.22	
		13,326,876.81					13,326,876.81
				Dec. 31.	By ledger #2	13,326,876.81	
		Morenci					
1919 Dec. 31.	To balance	1,754,913.10		1917 April 2.	10 By sundries	815,851.83	
				Dec. 31.	24 " mine deple.	166,758.12	
				1918 Dec. 31.	82 " " "	417,979.32	
				1919 Dec. 31.	244 " " "	354,323.83	
		1,754,913.10					1,754,913.10
				1920 Dec. 31.	By ledger #2	1,754,913.10	
		Burro Mountain					
1919 Dec. 31.	To balance	1,208,713.98		1917 April 2.	11 By sundries	227,911.11	
				Dec. 31.	24 " mine deple.	248,163.89	
				1918 Dec. 31.	82 " " "	582,981	
				1919 Dec. 31.	244 " " "	149,657.98	
		1,208,713.98					1,208,713.98
				1919 Dec. 31.	By ledger #2	1,208,713.98	

65

Plaintiff's Exhibit L

Photostat of page 10 of ledger:

ORE RESERVE

1919 Dec. 31.	To balance	Copper Queen	22,964,685.91		1917 Apr. 2.	8	By sundries	22,964,685.91	
					1918 Dec. 31.		By ledger #2	22,964,685.91	
1919 Dec. 31.	To balance	Morenci	2,905,368.56		1917 Apr. 2.	10	By sundries	2,905,368.56	
					1919 Dec. 31.		By ledger #2	2,905,368.56	

66

Plaintiff's Exhibit M

Photostat of page 14 of ledger:

DEPLETION RESERVE. STAG CANON

1919 Dec. 31.	To balance	For Dawson Fuel Co. properties	346,748.68	346,748.68	1917 April 2.	12	By sundries	195,206.08	
					Dec. 31.	24	" mine deple.	47,370.23	
					1918 Dec. 31.	68	" daw. off.	62,220.37	
					1919 Dec. 31.	241	" " "	41,952	346,748.68
					1919 Dec. 31.		By ledger #2	346,748.68	
1919 Dec. 31.	To balance	For Stag Canon properties	32,985.29		1917 April 2.	12	By sundries	21,885.85	
					Dec. 31.	24	" Mine deple.	3,812.08	
					1918 Dec. 31.	68	" daw. off.	4,560.12	
				32,985.29	1919 Dec. 31.	241	" " "	2,727.24	32,985.29
					1919 Dec. 31.		By ledger #2	32,985.29	

Photostat of page 3 of ledger:

SURPLUS

1917					1917		
June 28.	80	To div. #1 & extra	3,600,000		April 2.	8	By Copper Queen	93,460,853.85	
Sept. 26.	87	" div. #2 & extra	2,250,000		" 2.	10	" Morenci	641,745.82	
Dec. 28.	124	" div. #3 & extra	2,250,000		" 2.	11	" Burro Mt.	251,199.84	
" 31.		" balance	118,155,155.67		" 2.	13	" Stag Canon	22,182.61	
				126,255,155.67	" 2.	14	" certif. of indebt.	31,450,000	
					" 13.	"	" P. D. Co.	429,173.55	
									126,255,155.67
1918					1917				
Mar. 29.	168	To div. #4 & extra	3,600,000		Dec. 31.		By balance	118,155,155.67	
June 28.	207	" " #5 & "	1,800,000		" 31.		" Gen. P. & L.	14,588,711.61	
Sept. 30.	4	" " #6 &	2,700,000		1918				
Dec. 31.	42	" " #7 & "	2,700,000		Dec. 31.	86	" Do.	10,101,616.66	
" 31.		" " balance	132,045,483.94						
				142,845,483.94					142,845,483.94
1919					1918				
Mar. 31.	112	To div. # 8	1,125,000		Dec. 31.		By balance	132,045,483.94	
June 30.	153	" " # 9	1,125,000						
Sept. 30.	182	" " #10	1,125,000		1919				
Dec. 31.	219	" " #11	1,125,000		Dec. 31.	252	" Gen. P. & L.	2,416,751.80	
"		" balance	129,962,235.74						
				134,462,235.74					134,462,235.74
					1919				
					Dec. 31.		By ledger #2	129,962,235.74	

Photostat of page 4 of ledger:

GENERAL PROFIT & LOSS

1917					
Dec. 31.	149	To exps. pro. committee		600. 25	
"	15	" charges		91, 185. 60	
"	21	" exps. plant		262, 258. 96	
"	22	" tailings exps.		14, 017. 12	
"	"	" sundries		30, 000. 09	
"	27	" mine depl. C. Q.		3, 065, 500. 20	
"	"	" " " Morenci		166, 758. 12	
"	"	" " " Burro Mt.		248, 163. 89	
"	"	" " " D. F. Prop.		47, 370. 23	
"	"	" " " Stag "		3, 812. 08	
"	"	" plant depr. C. Q.		315, 421. 03	
"	"	" " " Morenci		29, 143. 93	
"	"	" " " Burro Mt.		151, 156. 08	
"	"	" " " D. F. Prop.		34, 889. 19	
"	"	" " " Stag "		21, 894. 35	
"	"	" taxes		263, 721. 85	
"	"	" income tax accruals		2, 756, 647. 30	
"	28	" surplus		14, 588, 711. 61	
					22, 091, 252. 48
1918					
Dec. 31.	75	To charges		128, 397. 30	
"	"	" laboratory exp.		616. 25	
"	76	" U. S. 15/30 yr. 3½% bond		9, 690. 65	
"	"	" U. S. 10/25 yr. 4¼% bond		12, 150	
"	78	" sundries		4, 470. 86	
"	"	" priv. car, "Alamagordo"		2, 129. 43	
"	80	" sundries		2. 32	
"	82	" organ. mt. prosp.		345, 865. 53	
	82	" taxes		114, 807. 47	

1917					
Dec. 31.	135	By Caski.		4	
"	"	" London office		4. 77	
"	22	" sundries		3, 300, 219. 26	
"	147	" voucher		952. 08	
"	23	" inv. in sund. Co.'s		1, 687. 70	
"	28	" C. Q. profit & loss		16, 859, 103. 77	
"	"	" Morenci "		526, 363. 34	
"	"	" Burro Mt. "		709, 755. 71	
"	"	" Stag Canon "		633, 161. 85	
					22, 091, 252. 48
1918					
Dec. 31.	76	By Anglo Fr. Bonds		29, 045	
"	"	" U. K. Gt. B. & Ire. "		13, 461. 87	
"	"	" Daw. Ry. & C. Co. "		172. 50	
"	78	" tailings exp.		432. 99	
"	84	" div. from subs. Co's.		2, 470, 000	
"	"	" div. from sund. inv.		259, 124. 11	
"	"	" comm. earned		343, 098. 35	
"	"	" discts. R. & A.		1, 707. 87	
"	"	" interest		503, 527. 58	
"	85	" C. Q. P. &L.		11, 983, 941. 89	

GENERAL PROFIT & LOSS—Continued

Dec. 31.	84	To charities & D.			535,375
"	"	" charges			47,286.80
"	85	" mine deple. C. Q.			3,006,610.30
"	"	" " " Mor.			417,979.32
"	"	" " " B. Mt.			592,981
"	"	" " " D. F. Prop.			62,220.37
"	"	" " " Stag			4,560.12
"	"	" plant depre. C. Q.			363,071.42
"	"	" " " Mor.			51,872.75
"	"	" " " B. Mt.			217,440.81
"	"	" " " D. F. Prop.			46,518.92
"	"	" " " S. C. Br.			38,428.16
"	86	" inc. tax accruals			2,707,328.11
"	"	" surplus			10,101,616.66
					18,800,519.55
1919					
Dec. 31.	206	To pur. dept. exp.			15.40
"	207	" charges			146,340.63
"	"	" organ. mt. pros.			3,371.62
"	223	" inv. sundry Co s.			13.42
"	233	" plant & eq. C. Q.			6,270.82
"	245	" Stag C. pay			.01
"	249	" sundries			97,760.60
"	"	" mine depletion			2,921,877.27
"	250	" sundries			294,530.14
"	"	" C. Queen plant dep.			363,239.98
"	"	" Mor. " "			51,483.40
"	"	" Burro Mt. " "			215,450.56
"	"	" daw. F. prop. "			155,063.06
"	"	" stag C. " "			89,108.97
"	"	" in rails & fort prior to 1918			29,800
"	"	" in rails & fort for 1918			17,599.95
"	251	" sundries			292,614.58
"	252	" Do			8,789,601.44
"	"	" inc. tax accruals			273,585.72
"	"	" surplus			2,16,751.80
					16,163,512.37

Dec. 31.	85	By mor.	"	"	958,203.01
"	"	" B. Mt.	"	"	1,116,194.71
"	"	" Stag	"	"	1,112,802.69
"	"	" Cope. B.	"	"	8,676.98
					18,801,519.55
1919					
Dec. 31.	228	By Daw. R. & C. Co. Bank			5,235
"	249	" Sundries			3,000,722.97
"	250	" "			1,112,898.04
"	251	" gen. P. & L.			155,063.06
"	"	" " "			89,108.97
"	"	" " "			29,800
"	"	" " "			17,599.95
"	"	" sundries			7,788.49
"	252	" "			11,214,967.03
"	"	" inc. tax accru.			531,328.86
					16,163,512.37

Photostat of page 32 of ledger:

RESERVE FOR DEPLETION (DEPLETION RESERVED)

1917				Sept. 30, 1917		
Sept. 27.	To N. Y. voucher dfts.	R. 85	520,000.00	as		
Dec. 27.	" do	" 94	520,000.00	Dec. 31, 1916. By mine depreciation reserve	J. 43	3,127,944.74
31.	" profit & loss	J. 50	2,585,585.50	1917		
	balance		3,701,774.74	Dec. 31. By mine depreciation	" 48	2,985,585.50
				31. " profit & loss	" 50	1,613,880.00
			7,727,360.24			7,727,360.24
1918				1917		
Mar. 26.	To P. D. Corpn.	R. 102	260,000.00	Dec. 31. By balance		3,701,774.74
June 27.	" do	" 110	260,000.00	1918		
Sept. 26.	" do	" 119	260,000.00	Dec. 31. " mine depletion	J. 56	1,589,462.00
Dec. 31.	" do	" 128	520,000.00			
31.	balance		3,991,236.74			
			5,291,236.74			5,291,236.74
1919				1918		
Dec. 31.	To profit & loss	J. 65	932,578.00	Dec. 31. By balance		3,991,236.74
"	balance		4,867,707.96	1919		
				Dec. 31. " mine depletion	J. 63	932,578.00
				31. " profit & loss	" 65	876,471.22
			5,800,285.96			5,800,285.96
				1919		
				Dec. 31. By balance		4,867,707.96
				1920		
				Dec. 31. " mine depletion	J. 71	776,198.84

71 PLAINTIFF'S EXHIBIT Q

Extract of photostat of page — of ledger:

ORE RESERVE

Sept. 30, 1917, as Dec. 31, 1916. By surplus		J. 43	4,970,649.26

PLAINTIFF'S EXHIBIT R

ANNUAL REPORT PHELPS DODGE CORPORATION, 1917

NEW YORK, *February 28, 1918.*

To the stockholders of Phelps Dodge Corporation:

GENTLEMEN: In a letter to the stockholders under date of March the 31st, 1917, the plan of reorganization was outlined to you whereby the name of the Copper Queen Consolidated Mining Company was changed to Phelps Dodge Corporation and its capital stock increased. At the same time the properties of the Detroit Copper Mining Company of Arizona, Burro Mountain Copper Company, and Stag Canon Fuel Company, and also the stocks of the Moctezuma Copper Company, Bunker Hill Mines Company, and
72 Phelps Dodge Mercantile Company were transferred to Phelps Dodge Corporation. Later, in continuance of this plan, at a meeting of the stockholders of Phelps, Dodge & Company, held on May the 15th, 1917, the stockholders voted and consented to the dissolution of Phelps, Dodge & Company. The former subsidiaries of Phelps, Dodge & Company are now designated as Copper Queen branch, Morenci branch, Burro Mountain branch, and Stag Canon branch of Phelps Dodge Corporation.

During the early part of the year the market price of copper reached a record figure, which acted as an incentive to push production to the maximum. The output for the first six months from your properties reached the large figure of 80,497,835 pounds. In June and July, labor troubles, fomented at Bisbee by the I. W. W. and at Morenci by the local Mexican union, served in the case of the Copper Queen branch to seriously affect the ore production and in the case of the Morenci branch to cause complete suspension of operations for a period of four months. In September the United States Government fixed an arbitrary market price for copper at 23½ cents per pound, which obtained through the balance of the year. Owing to the greatly increased production costs, due to the high cost of labor and supplies, and the seriously decreased efficiency of labor, this price caused a certain reduction of output because of the inability to work profitably low grade ore which previously had allowed a small margin of profit.

The metal produced from the ores of the branches and sub-
73 sidiaries of the Phelps Dodge Corporation was 153,974,692 pounds of copper, 8, 136,356 pounds of lead, 1,524,632 ounces

purchased or smelted on toll at the reduction works, ores yielding 51,907,525 pounds of copper, 946,921 ounces of silver, and 10,957 ounces of gold.

Including copper received from other sources, 290,522,569 pounds were sold and delivered to buyers at a price of 26.67 cents per pound, net cash f. o. b. New York.

	Pounds
To domestic trade	185,131,891
To foreign trade	105,390,678
The company sold:	
Of their own mine product	156,114,518
Of copper from ores purchased	16,681,572
Of copper on commission	117,726,479
The above consisted of:	
C. * Q. electrolytic copper	274,449,140
P. D. ingot copper	15,528,429

Throughout the year the demand for copper greatly exceeded the supply and the fluctuations in the price between the maximum of 33¾ cents per pound in the early part of the year and 23½ cents during the last third are indicative of the market conditions and the uncertainty of the trade. Through the fixed principle pursued by the selling agency of your company the average price obtained for the copper output of your companies exceeded that received in 1916 by 2.19 cents per pound, although the quotational average as published by the Engineering and Mining Journal was slightly lower than the previous year.

The copper production derived from the mines of the Cop-
74 per Queen Branch, after reaching record production the first six months, showed a marked decrease in the latter half of the year, the yield being 87,831,317 pounds of copper, as compared with 95,397,219 pounds for 1916. This result was largely due to the labor troubles and the loss of skilled miners through the operations of the selective draft. A large increase in the holdings of mineral ground in the Warren district has been acquired by the Copper Queen branch through the purchase of the mining claims of the Warren Realty & Development Company and the Rough Rider Group, aggregating about 2,074 acres.

At the Morenci branch the strike completely stopped the production of copper for four months and caused a very much reduced output for November and December. It is probable that the normal production of this property will not be reached until after the first half of the current year, owing to the operating difficulties in obtaining normal production after a prolonged shut-down.

The Moctezuma Copper Company, operating in Sonora, Mexico, was enabled, through more satisfactory political conditions in that State, to reach its highest output on record, and while the cost of producing copper from this property has greatly increased on account of the heavy Mexican State and Federal taxes and the higher prices paid for supplies and labor, the financial outcome of the year's operations may be regarded as satisfactory.

The Burro Mountain branch produced 13,139,053 pounds of copper as against 6,980,885 pounds during the previous year, and experienced no difficulties with its labor. Because of the
75 satisfactory development of this company's ore reserves during the past three years, the mill capacity will be still further increased and a larger production attained.

At the Stag Canon branch, the mines and ovens operated continuously throughout the year and both the output and the financial result of the operations were extremely satisfactory.

At the mines of the Bunker Hill Mines Company, operations during the past year have not opened up any new ore bodies of value, notwithstanding the active development work that was done above water level.

At Organ, New Mexico, prospecting operations were continued under disadvantageous circumstances. No ore of importance has been developed to date on the upper levels and the work on the lower levels now under way should demonstrate in the near future whether the property has any value to us.

In August the Phelps Dodge Corporation purchased from the Commercial Mining Company all of its real and personal property, including its mines in Yavapai and Mohave Counties in Arizona. These properties, while of minor importance at the present time, are profitable and may develop into more important producers in the future.

While the general labor shortage throughout the West made it impossible to carry out the normal amount of development work looking to the exploration of new ore bearing areas, it is satisfactory to be able to report that, without exception, the known ore reserves have been materially increased in all of your mines.

76 Dr. James Douglas, who for many years has been president of your company, tendered his resignation as president on account of ill health, and in the words of the following resolution, was appointed chairman of the board of directors:

"Whereas, after thirty-five years of activity in the development of the properties of this company and its subsidiaries, whose success is largely due to his rare skill and untiring efforts, President Douglas has intimated his desire to be relieved of the burdens of administrative detail, and has presented his resignation as president of this company; and

"Whereas, the board of directors, desirous of doing what will be most helpful to Dr. Douglas, nevertheless feel, that after all these years of cordial cooperation they cannot permit him to entirely sever his official relations with the company; and desire to retain him in a position where, without being burdened with matters of detail, he may still give the company the benefit of his long experience, by wise counsel and advice:

"Be it therefore, resolved, that the resignation of Dr. James Douglas as president of this company is accepted with regret and that he is hereby appointed chairman of the board of directors, and

is authorized and empowered to manage the affairs and business of the company and to bind the company by his acts and signature with the same effect as though he were president of the company."

77 Mr. Walter Douglas was elected president. Mr. S. W. French, formerly general manager, has resigned, and Mr. A. T. Thomson, assistant to the president, has been transferred to Douglas, Arizona. Mr. P. G. Beckett, formerly general manager of the Old Dominion Company, has been appointed assistant to the president, with headquarters in New York.

Four dividends of 2½% each and extra dividends of 3½% in March, 5½% in June, 2½% in September, and 2½% in December, amounting to 24%, exclusive of 8% distributed from the "Reserve for depletion," or 32% in all, were paid during 1917. Of these dividends, as pointed out in a statement to stockholders under date of January 29, 1918, the dividend paid in March, 1917, was paid by Phelps, Dodge & Company and was declared and paid entirely out of the profits accrued during the year 1916. The other three regular dividends and extras were paid by Phelps Dodge Corporation out of earnings for the year 1917, and the special dividends of September and December were a "distribution from the reserve for depletion."

WALTER DOUGLAS,
President.

78 *Phelps Dodge Corporation balance sheet, 31st December, 1917 (including assets and liabilities of subsidiary companies owned)*

ASSETS

Fixed:		
Mines and mining claims	$179,630,650.83	
Buildings, plants, and miscellaneous properties	15,774,741.60	
Investments in sundry companies	3,129,481.03	
		$198,534,873.46
Current:		
Materials and supplies and expenses prepaid	3,439,360.32	
Merchandise held for sale	2,123,820.34	
Metals on hand—copper at cost, silver and gold at market	8,613,871.88	
Accounts receivable	5,880,185.60	
Cash and marketable securities	13,775,627.84	
		33,832,865.98
		232,367,739.44

LIABILITIES

Capital stock:		
Authorized—500,000 shares, of $100.00 each.		
Issued—450,000 shares		$45,000,000.00
Current:		
Accounts and wages payable and taxes accrued		9,523,198.19
Reserves:		
For depletion—after deducting $3,600,000.00 distributed to stockholders in 1917	$41,657,487.95	
For depreciation	4,290,206.42	
		45,947,694.37
Surplus—per surplus account attached		131,896,846.88
		232,367,739.44

79 *Phelps Dodge Corporation profit and loss account (including operations of subsidiary companies owned), year ending 31st December, 1917*

Income:		
Sales of copper, lead, silver, and gold	$48, 978, 771. 56	
Sales of coal, coke, and merchandise	12, 182, 687. 21	
Income from investments and miscellaneous earnings	1, 100, 726. 95	
		$62, 262, 185. 72
Expenses:		
Mining, treating and refining metals	21, 545, 456. 51	
Cost of coal, coke, and merchandise sold	10, 508, 162. 20	
Depreciation of buildings and plants	1, 097, 431. 77	
General and administrative expense	796, 633. 71	
State and governmental taxes	5, 857, 595. 21	
		39, 805, 279. 40
Profits for the year 1917—carried to surplus account		22, 456, 906. 32

SURPLUS ACCOUNT

Balance 31st December, 1916	15, 687, 126. 42
Increase in valuation of mines to comply with Government regulations	110, 069, 340. 81
Profit for the year 1917—profit and loss account	22, 456, 906. 32
	148, 213, 373. 55
Provision for depletion of mines—year 1917	5, 516, 526. 67
	142, 696, 846. 88
Dividends paid	10, 800, 000. 00
Balance 31st December, 1917—carried to balance sheet	131, 896, 846. 88

On account of the shortage of labor, the production of lead ores was sacrificed to the effort to mine all copper ore possible, resulting in a decreased tonnage of this material as compared with the previous year.

80 PRODUCTION OF REDUCTION WORKS

The number of tons of ore charged and the ounces of gold and silver and pounds of copper produced at the reduction works follow:

	Dry tons charged	Ounces gold	Ounces silver	Pounds copper
Copper Queen Branch	794, 904	19, 171	550, 156	87, 831, 317
Burro Mt. Branch	45, 868	293	36, 799	13, 342, 508
Moctezuma Copper Co	167, 381	1, 910	508, 387	38, 499, 781
All other	268, 664	10, 957	946, 921	51, 907, 525
Total 1917	1, 276, 817	32, 331	2, 042, 263	19', 581, 131
Total 1916	1, 304, 523	32, 832	1, 794, 854	17', 893, 880

PLAINTIFFS' EXHIBIT S

Consolidated return as required by regulations 41, art. 78 and Treasury Decision 2662.

CORPORATION EXCESS PROFITS TAX RETURN

Taxable year ended 31st December, 1917. Name, Phelps Dodge Corporation. Business address, 99 John Street, New York. Kind of business, general mining & mercantile business. Date established, Dec. 14, 1908.

SCHEDULE I.—*Net income for taxable year subject to excess profits tax*

1. Net income for taxable year shown in item 8, Form 1031, for this and all affiliated companies per statement "F" attached		$22, 970, 791. 62
		22, 970, 791. 62
4. Less (a) dividends received as shown in item 3d, Form 103, per statement "F" attached	$2, 699, 351. 71	
(b) Interest paid		2, 699, 351. 71
Net income subject to excess profits tax		20, 271, 439. 91

81

SCHEDULE II.—*Invested capital*

Item	1911	1912	1913	Taxable year
1. Capital, surplus, and undivided profits at the close of the preceding year as shown by corporation's books before making any adjustments therein	$44, 671, 873. 61	$45, 712, 274. 75	$51, 129, 679. 67	$55, 809, 708. 81
2. Adjustments by way of additions	45, 000, 000. 00	45, 000, 000. 00	45, 000, 000. 00	49, 532, 146. 78
3. Total	89, 671, 873. 61	90, 712, 274. 75	96, 129, 679. 67	105, 341, 855. 59
4. Adjustments by way of deductions				
5. Invested capital at beginning of year	89, 671, 873. 61	90, 712, 274. 75	96, 129, 679. 67	105, 341, 855. 59
6. Changes in invested capital during year				
7. Invested capital for year	89, 671, 873. 61	90, 712, 274. 75	96, 129, 679. 67	105, 341, 855. 59
8. Total invested capital for pre-war period				276, 513, 828. 03

SCHEDULE III.—*Deduction*

1. Percentage—net income to invested capital for pre-war period	10. 5%
2. Percentage to be used in computing deduction	9. %
3. Amount of deduction computed at above rate on invested capital for taxable year	$9, 480, 767. 00
4. Exemptions (except for foreign corporations)	3, 000. 00
Total Deduction	9, 483, 767. 00

82 SCHEDULE IV.—*Computation of Tax*

Classes of income for computation of tax.—Over $0.00, but not over 15% of invested capital; amount of income in this class, $15,801,278.34; deduction, $9,483,767.00; balance subject to tax, $6,317,511.34; rate, 20%; amount of tax, $1,263,502.27.

Classes of income for computation of tax.—Over 15% of invested capital; but not over 20% of invested capital; amount of income in this class, $4,470,161.57; balance subject to tax, $4,470,161.57; rate, 25%; amount of tax, $1,117,540.39.

SUMMARY

Total: Amount of income in each class, $20,271,439.91; deduction, $9,483,767.00; balance subject to tax, $10,787,672.91; total amount of tax, $2,381,042.66.

83 SCHEDULE A.—*Capital, surplus, and undivided profits as shown by books before making any adjustments therein*

Item	1911	1912	1913	Taxable year
Capital stock paid up and actually outstanding at the close of the preceding year:				
3. Common	$45,000,000.00	$45,000,000.00	$45,000,000.00	$45,000,000.00
Total	45,000,000.00	45,000,000.00	45,000,000.00	45,000,000.00
6. Earned surplus	328,126.39	712,274.75	6,129,679.67	10,809,708.81
8. Grand total	44,671,873.61	45,712,274.75	51,129,679.67	55,809,708.81

SCHEDULE B.—*Adjustments by way of additions*

Item	1911	1912	1913	Taxable year
2. Value of tangible property in excess of par value of stock issued therefor as of date of issue see supplementary statement attached marked "A"	$45,000,000.00	$45,000,000.00	$45,000,000.00	$45,000,000.00
4. Depreciation charged in accounts of corporation but disallowed by Treasury Department as expense on income tax return				4,532,146.78
Total	45,000,000.00	45,000,000.00	45,000,000.00	49,532,146.78

SCHEDULE F.—*Net income during pre-war period*

Item	1911	1912	1913
3. Total for each year	$8,440,401.14	$12,167,404.92	$10,446,173.65
5. Net total for year 1913			10,446,173.65
6. Grand total for pre-war period			21,053,979.71

84 QUESTIONS

1. Explain the nature of the corporation's business if not adequately described on first page:

(a) Main business mining and treating copper ores and selling metal.

(b) Collateral businesses, if any coal mining and general mercantile business.

2. Date of incorporation. See statement "A" attached.

3. Under the laws of what State or country?

4. Enter on the following lines the names and addresses of three representative concerns in your locality engaged in the same kind of business. See statement "A" attached.

5. What was the fair value of the total capital stock of the corporation as determined in the last assessment of the capital stock tax (if any)? Specify the year $135,000,000.00 in 1917.

6. If any patent is included among your assets attach a schedule to this return showing for each patent its serial number, date of issue, name of patentee, amount of cash or stock paid therefor, and its present book value. None.

85 STATEMENT BY PHELPS CORPORATION, ANNEXED TO 1917 EXCESS PROFITS TAX RETURN

This corporation was formerly organized as of March 1, 1917, and is a continuation of the business of Phelps, Dodge & Co., Inc. The latter company was the incorporation in December, 1908 of the long established partnership of Phelps, Dodge & Company, which had owned and operated valuable mines in the southwest for a number of years prior to that time. Phelps Dodge Corporation owns the physical properties of all the companies taken over by Phelps, Dodge & Co., Inc., at the time of its organization, except those of the Moctezuma Copper Company, which by reason of their location in Mexico are retained in a separate corporation. In addition, it owns the capital stock of Phelps, Dodge Mercantile Company, and the mines of the Burro Mountain Copper Co., both acquired by Phelps, Dodge & Co., Inc., since the year 1908. In substance, in form, in manner of organization, in par value of capital stock ($45,000,000.00), and in tangible property owned Phelps Dodge Corporation is the same as Phelps, Dodge & Co., Inc., and should be so regarded.

With regard to invested capital, the company submits the following statement:

The par value of its capital stock is $45,000,000. This was valued by the Government in the year 1917, for the purpose of the capital stock tax, as $300 a share, giving a value of $135,000,000 fixed by the Government for the purpose of taxing it. This valuation was not

disputed by the company. The dividends of the company for
86 the year 1917 were $32 per share, or $14,400,000 which on a 10% basis would give a value of $144,000,000. The company's principal properties are as follows:

The Copper Queen mines at Bisbee, Arizona.
The Detroit Copper mines at Morenci, Arizona.
The Burro Mountain mines at Tyrone, New Mexico.
The Stag Canon mines at Dawson, New Mexico.
The Moctezuma mines at Nacozari, Mexico.
The Phelps Dodge Mercantile Co. stores.
The smelter at Douglas, Arizona.

However, the company is advised that by reason of the technical restrictions of section 207 of the war excess profits tax law, it will be unable to use its real invested capital for the year 1917 and at the same time comply with said restrictions. It is advised that the intent of section 207 is to prevent the taxpayer using his real invested capital for the taxable year, and to compel him to compute the same according to certain artificial rules and definitions therein contained. The chief of these is that when tangible property was paid in prior to January 1, 1914, for stock or shares of the corporation the invested capital must be taken as the value of such assets, not as of the taxable year, and to compel him to compute the same according to certain artificial rules and definitions therein contained. The chief of these is that when tangible property was paid in prior to January 1, 1914, for stock or shares of the corporation, the invested capital must be taken as the value of such assets,
not as of the taxable year, but as of January 1, 1914, and
87 even then in no case to exceed the par value of the original stock or shares specifically issued therefor.

Although the real invested capital of the company on January 1, 1914, was at least $135,000,000 the company is advised that the above restriction of the par value of the capital stock if valid, prevents its using its invested capital as of that date, provided, however, that the difference between the par value of the capital stock and the then value of the assets for which the stock was issued, can be treated as "paid-in surplus." The company is advised that the above provision that the value of the assets on January 1, 1914, shall not exceed the par value of the capital stock is an artificial and improper method of classification, and is invalid. It is advised that such a limitation will result in inequality of taxation as between companies with the same real assets as the par value of the capital stock is in no sense an index of real value. That it will discriminate against companies conservatively capitalized and that it will discriminate particularly against mining companies in that it seeks to prevent their using as a part of their capital, new ore bodies uncovered by the expenditure of large sums for development work.

The company, therefore, submits this statement and the annexed return, computing its invested capital in accordance with section

207 of the war excess profits tax law, and article 63 of "Regulations No. 41, relative to the war excess profits tax," under pro-
88 test and without prejudice or waiver of its right to contend later if it is so advised, that the methods of computing invested capital set forth in section 207 of said law, particularly the provision thereof limiting it to the value of its assets as of January 1, 1914, and not as of the taxable year, and even as to that date limiting said value to the par value of the capital stock, are invalid and void.

As of November 1, 1908, the smelters, mills, metal on hand at cost, and other assets of the companies then taken over by Phelps Dodge & Co., Inc., exclusive of the mines were valued at $28,949,739.53 with liabilities of $4,161,166.06 leaving a net value of assets, exclusive of mines of $24,788,573.47. This was unquestionably considerably below the real value of these assets as the policy of the company was to value its assets very conservatively. For instance, if copper on hand had been valued at the market and not at cost, it would have increased these values several million dollars.

As to the value of the mines taken over, any mining expert would advise that the mines were worth at least three or four times the value of the above plant and quick assets. From what was known of the mines in November, 1908, a value of from $75,000,000 to $125,000,000 would be conservative. So that the value of the mines, plant and quick assets for which the $45,000,000 stock was issued was from $100,000,000 to $150,000,000. The par capital stock was fixed at a comparatively small figure, because the stock was closely held. It was not intended to create a wide market for it, and it was deemed wise to err on the side of conservatism. While stock
89 capital of $90,000,000 to $150,000,000 was discussed and favorably considered at the time $45,000,000 was adopted as an amount on which the company could pay satisfactory dividends, even under the most adverse conditions, which could be imagined.

The market value of the stock in December, 1908, throws no light upon the subject, for the reason that the properties had always been private. There was no stock then upon the market. There were no transactions and no stocks for sale. In the year 1909 there were a few transactions, for the directors had issued $1,000,000 of stock to the employees at par, and some of this stock coming upon the market gave market sales valuations as follows:

On February,	1909	$175
May 28,	"	200
June	"	200
July 19,	"	225
July 22,	"	235
Dec. 29,	"	252

Considering the real value of the mines taken over (the Copper Queen, Detroit, Moctezuma, and Stag Canon) it is fair to give them a value of from $90,000,000 to $100,000,000. The earnings of the four properties taken over for three years last passed had averaged

about $7,400,000 per annum and that with only one company (the Copper Queen) in any way approaching its normal capacity. As to that company the valuation of its properties was corroborated, not only by its own explorations, but by those of the Calumet & Arizona Mining Co., whose properties are adjacent to those of
90 the Copper Queen, in Bisbee, Arizona, and are of much the same character. Both of these explorations indicated the continuance of a very large territory of high grade copper ore. The Copper Queen was widely known as one of the most valuable and extensive copper properties in the Southwest. Its mines were very extensive in area and were known to lie in one of the richest copper districts in the country. The properties owned by the Moctezuma Copper Co. and the Detroit Copper Co. were extensive, and the values ran throughout the territory. The earnings of neither one of these companies for the three years prior to the organization of Phelps, Dodge & Co., Inc., represented in any way the known earning capacity. For instance, the Moctezuma Copper Co. had just practically finished its development period. It had been producing an average of 10,000,000 to 11,000,000 pounds of copper per year, and that with a mill whose capacity was only 600 tons a day. This mill had just been abandoned and a new mill with a capacity of 2,000 tons a day put into operation, so that in the month of October, 1908, the company had produced 2,300,000 pounds of copper. It is therefore fair to assume that the earnings of that company should be based on practically 30,000,000 pounds of copper per year and would be at least three times the earnings shown during the development period. The company owned the town of Nacozari, in Mexico, with a library, hospital, hotel, boarding house, schools, workmen's houses, etc. The Detroit Copper Co. also had not been operating up to its normal capacity, as it had been producing an average
91 of only about 17,000,000 pounds of copper per year, whereas in the year 1908 improved facilities for treatment had increased the normal capacity of 2,000,000 pounds a month. The mines of the Stag Canon Fuel Co. were of great value. Among the other properties owned by this company were 36,000 acres of land underlaid by coal, and the company had the right to mine coal from an additional 17,500 acres. From a survey made at the time, it was estimated that from one of these beds, making the usual allowance for loss, over 200,000,000 tons of coal could be extracted. Just before the taking over of these properties they were equipped for a total capacity of 120,000 tons of coal a month, whereas in January, 1908, only 65,000 tons had been mined, and in February, 1908, only 41,688 tons. The company also owned coke ovens with a capacity of 27,000 tons a month. The total net earnings of the company during the fiscal year ending June 30, 1908, which was a year of deep industrial depression, and with only a part of the coke ovens in operation, amounted to $283,942.

In addition to the above plant, quick assets, and mines, the old firm of Phelps, Dodge & Co., also transferred to the new company its valuable metal selling business, and good will, which were not taken into account at all, in the stock issue.

From the above statement it seems clear that the opinion of the men who were acquainted with the value of these properties when they were acquired, to the effect that some $90,000,000 to $100,000,000 was a conservative value in 1908, is amply justified by the facts known at the time. The subsequent earnings of the com-
92 pany and the proven ore on hand to-day indicate that this judgment was conservative. In view of the fact that the Moctezuma mines are still held by a separate corporation and irrespective of their value in December, 1908, the company has decided to take the lower figure for the purpose of this tax and to fix a paid in surplus of $45,000,000 in accordance therewith.

From the date of its organization down to December 31, 1916, the campany's net profits were $75,642,213.09, of which it has paid out in dividends $60,300,357.50, leaving an earned surplus, 1909 to 1916, inclusive, of $15,341,855.59.

The invested capital of the company, therefore, even as limited by the technical limitations of the war excess profits tax law was, on December 31, 1916, as follows:

Capital stock	$45,000,000.00
Paid in surplus	45,000,000.00
Earned surplus	15,341,855.59
Total	105,341,855.59

If the above invested capital be disallowed by reason of any technical restriction not known to the company, it will be obliged to ask the Commissioner of Internal Revenue to fix the value of its invested capital in accordance with section 210 of the war excess profits tax laws, and article 52 of the above regulations, subdivisions (1), (3), and (4).

Dated, April 1, 1918.

PHELPS DODGE CORPORATION,
By (Signed) WALTER DOUGLAS, *President.*

93 CORPORATION INCOME TAX RETURN

Return of annual net income for the calendar year 1917 (Dec. 31, 1917):

Name of corporation, Phelps Dodge Corporation. Principal office, 99 John Street. Kind of business carried on, general mining business. Date of organization, Dec. 14, 1908.

1. (a) Paid-up "common stock"	$45,000,000
Total paid-up stock	45,000,000

INCOME

3. (a) Gross sales and other income from operations		$39,364,830.43
(c) Income from interest		326,485.62
(d) Income from dividends		2,699,251.71
(e) Income from all other sources		336,169.63
Total gross sales and other income		42,726,737.39
Less total deductions		25,348,750.77
8. Total net income		17,377,986.62
Less: (a) Excess profits tax (item 12)	$1,842,672.59	
(b) Dividends received out of earnings of 1913, 1914, 1915		
Total (a plus b)		1,842,672.59
94 9. (a) Amount taxable at 2% (item 8 less total of a plus b)		15,535,314.03
10. Amount of total net income shown in item 8		17,377,986.62
Less: (a) Excess profits tax (item 12)	$1,842,672.59	
(b) Dividends received (item 3d)	2,699,251.71	
Total (a plus b)		4,541,924.30
11. Amount taxable at 4%		12,836,062.32

DEDUCTIONS

(See corresponding items on back of return.)

4. (a) Cost of goods and other property sold	$20,298,743.99
5. (b) Depreciation charged off	552,505.18
(c) Depletion charged off	3,531,604.52
7. (a) Domestic taxes paid, not including income and excess profits taxes	965,897.08
Total deductions	25,348,750.77

TAX

12. Amount of excess profits tax	$1,842,672.59
13. Amount of 2% tax (2% of item 9a)	310,706.28
15. Amount of 4% tax (4% of item 11)	513,442.49
16. Total tax assessable	2,666,821.36

95 We, the undersigned, president and treasurer of the above-named company, whose return of net income is herein set forth, being severally duly sworn, each for himself, deposes and

says that the items entered in the foregoing report and in the supplementary statement and in any additional list or lists attached to or accompanying this return are, to his best knowledge and belief, true and correct in each and every particular.

WALTER DOUGLAS,
President.
GEORGE NOTMAN,
Treasurer.

Sworn to and subscribed before me this ---------- day of ----------, 19--

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[SEAL OF OFFICER TAKING AFFIDAVIT.]

SUPPLEMENTARY STATEMENT

3. (c) From other sources. Income received from all sources not elsewhere specified should be itemized below:

Commission and discount	$334,481.93
Profit on securities sold	1,687.70
Total	336,169.63

4. (a) Cost of goods and other property sold:

Merchandise bought for sale	2,091,248.99
Cost of manufacturing or otherwise producing goods	19,324,411.68
96 Plus inventories at beginning of year	4,347,386.75
Total	25,763,047.42
Less inventories at end of year	5,464,303.43
Net cost of goods sold	20,298,743.99

5. (b) Depreciation:

Kind of property	Its cost	Probable life after acquirement	Amount of depreciation charged off	
			This year	Previous years
Mining plant, etc.	$12,458,007.70	15 years	$552,505.18	$2,296,430.33

5. (c) Depletion.

Kind of property	Its cost if acquired subsequent to Mar. 1, 1913	Fair market value as of Mar. 1, 1913	Amount of depletion charged off	
			This year	Previous years
Mines		$146,757,827.34	$3,531,606.52	$6,143,404.96

Basis of return.

Is this return made on the basis of actual receipts and disbursements? No.

If not, describe fully what other basis or method was used in computing net income Accrued earnings and expenses.

UNDISTRIBUTED INCOME, SURPLUS, AND UNDIVIDED PROFITS

Total net income of taxable year preceding that for which this return is made	$19,470,862.60
Amount of such income remaining undistributed six months after the close of that year	2,145,862.60
Amount of such income remaining undistributed twelve months after the close of that year	None
Total surplus and undivided profits at close of taxable year	135,500,514.58

97–108 [Omitted in printing.]

109 PLAINTIFFS' EXHIBIT T

MEMORANDUM FOR THE FILES

Dictated by J. L. Darnell, January 27, 1920.

In re tax returns of the Phelps Dodge Corporation, 99 John Street, New York City, for the year 1917

At a conference held to-day with Mr. Matthew C. Fleming, of counsel for the above corporation, it is agreed that the company should be permitted to add to the capital stock $45,000,000, a paid-in surplus of $45,000,000, as of the date of the organization of Phelps Dodge & Company in 1908, it being clearly shown that the values of the various properties as of this date were in excess of $90,000,000.

It is further agreed that the fair market values of the various properties owned or controlled by this corporation as of March 1, 1913, are as follows:

The Copper Queen limestone deposits	$65,369,000
The Copper Queen porphyry deposit	15,355,000
The Moctezuma	25,260,000
Burro Mountain	6,269,000
Morenci	8,832,000
	121,085,000

and that depletion from March 1, 1913, to the end of the taxable year is to be figured on these market values in conjunction with the estimates of recoverable copper, in the various properties, furnished by Mr. Gerald Sherman, the company's engineer, as set out in Schedule 1, statement submitted with schedule for depletion, 1909, to 1917, Form AOM.M.S., which is in the files.

110

It is further agreed that the valuation as of March 1, 1913, of the Stag Canon properties, shall be made in accordance with standard methods employed in the coal valuation section of the natural resources subdivision, and depletion of these coal properties computed by the engineers of the division.

After this is done and the statutory net incomes of the various companies have been determined in accordance with this memorandum, all questions of invested capital will be handled by the consolidated return section.

PLAINTIFF'S EXHIBIT U

TREASURY DEPARTMENT,

IT:T:CR—JZ—2752753

Washington, March 2, 1920.

PHELPS DODGE CORPORATION,
99 John Street, New York, N. Y.

SIRS: An examination of your income and consolidated excess profits tax returns filed by you and your affiliated companies for the calendar year 1917 has been made by this office and adjust-
111 ments have been made in respect to your taxable income and invested capital as outlined in Schedules 1 and 2 attached.

Respectfully,

(Signed) G. V. NEWTON,
Acting Assistant to the Commissioner.

CONSOLIDATED NET INCOME

Schedule 1

Net incomes:		
Phelps Dodge Corporation		$18,272,238.50
Detroit Copper Mining Co		701,967.91
Burro Mountain Copper Co		161,766.37
Stag Canon Fuel Company		53,421.21
Phelps Dodge & Co., Inc		134,370.14
Dawson Fuel Sales Co		7,454.69
Moctezuma Copper Co		3,710,899.77
Phelps Dodge Mercantile Co		808,703.17
Aggregate net income as adjusted		23,850,821.76
Adjustments—deduct dividends received:		
Phelps Dodge Corp	$3,739,251.71	
Detroit Copper Mining Co	100.00	
		3,739,351.71
Consolidated net income for excess profits purpose		20,111,470.05

112 PHELPS DODGE CORPORATION, CONSOLIDATED INVESTED CAPITAL

Schedule 2

Consolidated invested capital for the taxable year ending December 31, 1917, has been fixed as follows:

Par value of capital stock		$45,000,000.00
Paid in surplus		45,000,000.00
Earned surplus to Dec. 31, 1916		10,809,708.81
		100,809,708.81
Reserves:		
For bad debts	$84,981.77	
For 1916 taxes	737,211.76	
		822,193.53
		101,631,902.34

Adjustments by way of additions:		
Realized proportion of depletion due to appreciation	$8,109,572.49	
Excess reserve on books	1,419,968.17	
		$9,528,540.66
		111,160,443.00
Changes during taxable year:		
Deduct taxes for 1916 paid and assessed, $742,504.82, @ 6⅓ mos		404,252.63
Consolidated invested capital for calendar year 1917		110,756,190.37

113 PLAINTIFF'S EXHIBIT V

COPPER QUEEN CONSOLIDATED MINING COMPANY

	Gross income	Depletion per books	Dividends to P. D. & Co.	Depletion per Government figures
1913	$6,798,411.27	$524,469.20	$5,700,000.00	$3,509,727.43
1914	5,836,223.47	411,270.35	4,500,000.00	3,158,244.55
1915	6,290,086.43	534,563.70	7,000,000.00	3,572,104.82
1916	16,474,459.03	3,382,246.75	14,000,000.00	3,920,825.70
	35,399,180.20		31,200,000.00	14,160,902.50

114 PLAINTIFF'S EXHIBIT W

Address reply to
Commissioner of Internal Revenue
And refer to IT:G:P-S-IIP

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington May 3, 1921.

Mr. MATTHEW C. FLEMING,
170 Broadway, New York, N. Y.

SIR: Receipt is acknowledged of your letter of March 19, 1921, in reply to office letter of March 18, 1921.

In reply to your request as to whether it is proper for the company to use the department's depletion figures for the years 1913 to 1917, for the purpose of determining the net earnings of the company for those years, you are advised that article 841 of Regulations 45 permits corporations to correct returns of net income for prior years in which errors or adjustments have been made.

It is, therefore, permissible for the Phelps Dodge Corporation to use the department's depletion figures for the years 1913 to 1917 inclusive, in redetermining the earnings of the corporation for each of these years.

Respectfully,

E. H. BATSON,
Acting Deputy Commissioner.

115 PLAINTIFF'S EXHIBIT X

PHELPS DODGE CORPORATION,
99 John Street, New York, September 24, 1917.

Distribution from reserve for depletion

At a meeting of the trustees of Phelps Dodge Corporation on September 13, 1917, a distribution from the reserve for depletion of three dollars a share was declared, payable September 28, 1917, to all stockholders of record on this date. A check for your share of this distribution is enclosed.

GEORGE NOTMAN, *Treasurer.*

You are requested to deposit this check promptly.

PLAINTIFF'S EXHIBIT Y

PHELPS DODGE CORPORATION,
99 John Street, New York, December 28, 1917.

Distribution from reserve for depletion

At a meeting of the trustees of Phelps Dodge Corporation on December 13, 1917, a distribution from the reserve for depletion of five dollars a share was declared, payable December 28, 1917, to all stockholders of record on December 18, 1917. A check for your share of this distribution is enclosed.

GEORGE NOTMAN, *Treasurer.*

You are requested to deposit this check promptly.

116 PLAINTIFF'S EXHIBIT Z

Phelps Dodge Corporation—distribution from reserve for depletion

$123,150.00 No. 1112

NEW YORK, *Sep. 28, 1917.*

FIRST NATIONAL BANK OF NEW YORK:

Pay to the order of James Douglas one hundred twenty three thousand, one hundred fifty & no/100 dollars.

Good only when countersigned.

Special account.

PHELPS DODGE CORPORATION.
F. K. CAMERON, *Cashier.*

By C. W. PARSONS.

[Indorsement]

Pay to the order of Market & Fulton National Bank. James Douglas.

(By perforating marks:) Paid 9/29/17.

Market & Fulton National Bank. Received payment, Sep. 28, 1917, through N. Y. Clearing House receiving teller.

117 Phelps Dodge Corporation—dividend No. 2 & extra

$205,250.00 No. 652

NEW YORK, *Sep. 28, 1917.*

FIRST NATIONAL BANK OF NEW YORK:

Pay to the order of James Douglas two hundred five thousand, two hundred fifty & no/100 dollars.

Good only when countersigned.

Special account.

PHELPS DODGE CORPORATION.
F. K. CAMERON, *Cashier.*

By C. W. PARSONS.

[Indorsement]

Pay to the order of Market & Fulton National Bank. James Douglas.

(By perforating marks:) Paid 9/29/17.

Market & Fulton National Bank. Received payment Sep. 28, 1917, through N. Y. Clearing House receiving teller.

118 Phelps Dodge Corporation—distribution No. 2 from reserve for depletion

$205,250.00 No. 2159

NEW YORK, *Dec. 28, 1917.*

FIRST NATIONAL BANK OF NEW YORK:

Pay to the order of James Douglas two hundred five thousand, two hundred fifty & no/100 dollars.

Good only when countersigned

Special account.

PHELPS DODGE CORPORATION.
F. K. CAMERON, *Cashier.*

By C. W. PARSONS.

[Indorsement]

Pay to the order of Market & Fulton National Bank. James Douglas.

(By perforating marks:) Paid 12/29/17

Market & Fulton National Bank. Received payment Dec. 28, 1917, through N. Y. Clearing House receiving teller.

119 Phelps Dodge Corporation—dividend No. 3 & extra

$205,250 00 No. 1652

NEW YORK, *Dec. 28, 1917.*

FIRST NATIONAL BANK OF NEW YORK:

Pay to the order of James Douglas two hundred five thousand, two hundred fifty & no/100 dollars.

Good only when countersigned

Special account.

PHELPS DODGE CORPORATION.
F. K. CAMERON, *Cashier.*

By C. W. PARSONS.

[Indorsement]

Pay to the order of Market & Fulton National Bank. James Douglas.

(By perforating marks:) Paid 12/29/17.

Market & Fulton National Bank. Received payment Dec. 28, 1917, through N. Y. Clearing House receiving teller.

120 PLAINTIFF'S EXHIBIT A1

Phelps Dodge Corporation

Memorandum of various accounts which combined represent the reserve for depletion shown in published consolidated accounts as 31st, December, 1917.

On books of Phelps Dodge Corporation:	
Depletion reserve—Copper Queen (page 9 of ledger)	$7,948,050.29
Depletion reserve—Morenci (page 9 of ledger)	982,609.95
Depletion reserve—Burro Mountain (page 9 of ledger)	476,075.00
Depletion reserve—Stag Canon (page 14 of ledger)	268,274.24
Ore reserve—Copper Queen (page 10 of ledger)	22,964,685.91
Ore reserve—Morenci (page 10 of ledger)	2,905,368.56
Reserve for depletion (page 58 of ledger)	3,600,000.00
Total of various accounts on books of Phelps Dodge Corporation	31,945,063.95
On books of Moctezuma Copper Co.:	
Reserve for depletion	$3,701,774.74
Ore reserve	4,970,649.26
121 Total of various accounts on books of Moctezuma Copper Company	8,672,424.00
Total of various accounts on books of Phelps Dodge Corporation	31,945,063.95
Moctezuma Copper Company	8,672,424.00
	40,617,487.95
Add, for consolidation purposes, elimination of amount of distribution from depletion reserve, charged by Moctezuma Copper Co. on its books against reserve for depletion, paid to Phelps Dodge Corporation	1,040,000.00
Amount per published accounts 31st December, 1917	41,657,487.95

122 PLAINTIFFS' EXHIBIT A2

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, April 22, 1920.

Messrs. OSBORN, FLEMING & WHITTLESEY,
71 Broadway, New York, N. Y.

SIRS: Reference is made to your letter of March 26, in re claims for the refund of taxes on 1917 depletion dividends. You particularly call attention to the following claims:

Estate of Dr. James Douglas (George Notman & others executors)	$173,579.72
Cleveland H. Dodge	176,837.40
Mary M. H. Dodge	104,343.17

The claim of the estate of Dr. James Douglas for the refund of $173,579.72 has already been rejected. The claim was for the refund of taxes paid upon cash dividends specifically declared and paid between September 28 and December 31, 1917, out of depletion reserves of mining companies, even though at the time that the dividends were declared the company had on hand a surplus earned subsequent to February 28, 1913, out of which the amount of the dividends could have been distributed.

The claim was rejected under section 31 of the revenue
123 act of September 8, 1916, added by section 1211 of the act of October 3, 1917. That section provides as follows:

"(a) That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, * * *

"(b) Any distribution made to the shareholders or members of a corporation, joint-stock company, or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association, or insurance company, but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed in stock dividends or otherwise, exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made. This subdivision shall not apply to any distribution made prior to August sixth,
124 nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen."

The gist of your contention appears to be that the words of the provision "shall be deemed to have been made from the most recently accumulated undivided profits or surplus" create a presumption only that the dividends are paid out of such undivided profits or surplus, and that the presumption is subject to rebuttal by the presentation of evidence that the dividends were not paid out of such funds.

A statute which provides that a thing is to be "deemed" to be true, creates more than a disputable presumption; the matter must be considered as conclusively adjudged and established. Thus, in the case of Cardinel v. Smith, Fed. Cas. No. 2395, it was said:

"* * * Their counsel, apparently conscious that the letter of this section was against them, sought to modify its effect, by endeavoring to show that when it declares that 'a person who shall

offer or expose for sale, any of the articles named in Schedule C, * * * shall be deemed the manufacturer thereof,' it only creates a disputable presumption that such person is 'the manufacturer thereof,' which, in this case, is overcome by the admitted fact, that the plaintiffs are not the manufacturers, but only the vendors of the articles. The word 'deemed' in this connection means 'judged,' 'determined'; and when it is enacted that the vendor of an
125 article shall for any purpose, 'be deemed the manufacturer thereof,' for such purpose, he is to be absolutely considered such manufacturer. Indeed, it would be of little use for congress to declare that a vendor of canned goods, for the purpose of internal revenue, should be deemed a manufacturer thereof, if such declaration could be overcome and held for naught, by showing that, in fact, he was not such manufacturer."

And again, in the case of Leonard v. Grant, 5 Fed. 11, the court said:

"The word 'deemed' is the equivalent of 'considered' or 'judged'; and, therefore, whenever an act of congress requires to be 'deemed' or 'taken' as true of any person or thing, must, in law, be considered as having been duly adjudged or established concerning such person or thing, and have force and effect accordingly."

You contend further that since the unit values for depletion purposes represented the value of the ores on March 1, 1913, any distributions made from reserves for depletion were really distributions of amounts realized from the sale of capital assets in existence on March 1, 1913, and were not distributions from reserves accumulated subsequent to March 1, 1913. It has been held, however, that proceeds derived from mining operations constitute income and not merely converted capital. Stratton's Independence v. Howbert, 231 U. S. 399; Stanton v. Baltic Mining Co., 240 U. S. 103; von
126 Baumbach v. Sargent Land Co., 242 U. S. 503; Goldfield Consol. Mines Co. v. Scott, 247 U. S. 126. In the first case the court said:

"It is not correct, from either the theoretical the practical standpoint, to say that a mining corporation is not engaged in business, but is merely occupied in converting its capital assets from one form into another. The sale outright of a mining property might be fairly described as a mere conversion of the capital from land into money. But when a company is digging pits, sinking shafts, tunneling, drifting, stoping, drilling, blasting, and hoisting ores, it is employing capital and labor in transmuting a part of the realty into personalty, and putting it into marketable form. The very process of mining is, in a sense, equivalent in its results to a manufacturing process. And, however the operation shall be described, the transaction is indubitably 'business' within the fair meaning of the act of 1909; and the gains derived from it are properly and strictly the income from that business; for 'income' may be defined as the

gain derived from capital, from labor, or from both combined, and here we have combined operations of capital and labor."

And in the case of Stanton v. Baltic Mining Co., supra, the court said:

"But it is said that although this be undoubtedly true as a general rule, the peculiarity of mining property and the exhaustion
127 of the ore body which must result from working the mine, causes the tax in a case like this where an inadequate allowance by way of deduction is made for the exhaustion of the ore body to be in the nature of things a tax on property because of its ownership and therefore subject to apportionment. Not to so hold, it is urged, is as to mining property but to say that mere form controls, thus rendering in substance the command of the Constitution that taxation directly on property because of its ownership be apportioned, wholly illusory or futile. But this merely asserts a right to take the taxation of mining corporations out of the rule established by the sixteenth amendment when there is no authority for so doing. It moreover rests upon the wholly fallacious assumption that looked at from the point of view of substance a tax on the product of a mine is necessarily in its essence and nature in every case a direct tax on property because of its ownership unless adequate allowance be made for the exhaustion of the ore body to result from working the mine. We say wholly fallacious assumption because independently of the effect of the operation of the sixteenth amendment it was settled in Stratton's Independence v. Howbert, 231 U. S. 399, that such a tax is not a tax upon property as such because of its ownership, but a true excise levied on the results of the business of carrying on mining operations."

It appears to this office, therefore, that it was clearly the intention of Congress that all dividends paid by a going concern
128 should be taxed as though they had been paid from the most recently accumulated profits and surplus. It is not believed that it is competent for a corporation to declare a dividend out of profits earned prior to March 1, 1913, or from a depletion reserve, and escape tax while in point of fact the company has earnings in its surplus fund which accrued to it on and after March 1, 1913, and from which the dividend, or dividends could have been paid.

This office is endeavoring now to locate the claims and returns of Cleveland H. Dodge and Miss Mary M. H. Dodge, and when they are located the claims of these individuals will be respected, if the facts are the same as contained in the case of the claim of the estate of Dr. James Douglas.

Respectfully,

(Sgd.) WAYNE JOHNSON,
Solicitor.

128a

DEFENDANT'S EXHIBIT 1

INDIVIDUAL INCOME TAX RETURN FOR CALENDAR YEAR 1917

Made by James Douglas. Home address, Spuyten Duyvil, N. Y. City. Business, 99 John St., New York, N. Y.

Details of taxable income

A. Income from salaries, wages, commissions, bonuses, directors' fees, and pensions, and from professions.

By whom received	Occupation or profession	Name and address of employer or (if practicing a profession) office address	Gross income	
James Douglas	Executive	Phelps Dodge Corp., 99 John St., New York	$30,000.00	
		El Paso & Southwestern R. R. Co., 99 John St., New York, N. Y.	7,500.00	
Net income from salaries			37,500.00	$37,500.00

C. Profit from sale of real estate, stocks, bonds, and other property.

	Sale price	Original cost or market value March 1, 1913	
100 Marlin Arms, 1915, Marlin Arms Co., N. Y. C. Pref. Stk. 1915	$10,000.00	$9,000.00	
$20,000 Detroit Edison Bds. Mabon & Co., Wall St., N. Y.	28,716.00	21,683.33	
1,000 shs. Commercial Mining Co., Stk. Bot. 1894 for $100,000; sold Phelps Dodge Corp., 99 John St., N. Y. C.	15,000.00	15,000.00	
Totals	53,716.00	45,683.33	
Net profit from sales			$8,032.67

D. Income from rents and royalties.

	Amount of rent and royalties	Repairs, wear and tear, and property losses	Taxes	Other expenses
11 small tenant houses at Hudson Pk., N. Y. C., and one frame and brick house at 124 Cedar Ave., Montreal, Canada	$5,559.35	$1,292.90	$1,900.15	$544.64
Net income from rents and royalties				1,821.66

128b F. Dividends on stock of corporations organized or operating in the United States and subject to income tax.

If not received directly, state name of partnership or fiduciary through whom received.	Accumulated in 1913	Accumulated in 1914	Accumulated in 1915	Accumulated in 1916	Accumulated in 1917
	$453.00	$237.00	$225.00	$319,860.78	$1,098,287.65
Totals	453.00	237.00	225.00	319,860.78	1,098,287.65
Total net income from sources A, B, C, D, E, and F, reported on page 3					1,145,641.98

G. Interest on tax-free-covenant bonds (on which one normal tax of 2 per cent was withheld as source).

	Gross income	Deductions, if any	
Net interest on tax-free-covenant bonds (total column 1 minus total column 2)	$34,353.17	$385.42	$33,967.75

H. Other income (including income from partnerships and fiduciaries, except that reported under E, F, and G).

		Gross income
Interest on bonds and other obligations of domestic and resident corporations (except as entered under G), net		$7,741.00
Interest on bonds of foreign countries and corporations and dividends on stock of foreign corporations		24,072.44
Interest on notes, bank deposits, mortgages (except of corporations), and all other interest:		
(a) On notes	$18.30	
(b) On bank deposits	7,324.38	
(c) On mortgages (except corps.)	16,193.16	
(d) On all other interest	1,455.08	
	24,990.92	
		56,804.36

I. Total net income from all sources	$1,236,414.09
J. General deductions not reported on page 3 or above (except contributions—see N below).	

Interest on personal indebtedness		$165.85
Taxes on dwelling and personal property, and other taxes not reported above (see instructions on page 2)		14,277.08
Other deductions, except contributions (explain):		
Salaries of attornies, secretary, office expense	$14,974.07	
Rent paid, under lease, on property sub-leased	2,466.00	
Bad debt—loan to E. C. Douglas—January, 1914; no relative; Mr. D. ill, and no prospect of recovery	6,750.00	
	24,190.07	
Total general deductions, except contributions		$38,633.00

128c K. Total net income (without deducting excess profits taxes or contributions)	$1,197,781.09
L. Less excess profits taxes, if any, for 1917 (see instructions on page 1 under "Excess profits taxes")	2,520.00
M. Total net income (without deducting contributions) (K minus L)	1,195,261.09
N. Contributions to charitable organizations, etc. (Enter below name and address of each organization and amount paid to each.)	
Total of large gifts listed on detail sheet $460,444.96	
Total (not over 15 per cent of item M) 320,775.78	227,405.53
O. Total net income on which income tax is to be computed (M minus N)	967,855.56
18. Total net income on which income tax is to be computed	967,855.56
19. Less: Excess of interest received on obligations of United States issued since Sept. 1, 1917	00.00
20. Dividends	1,098,287.65
21. Personal exemption	2,000.00
22. Total of items 19, 20, and 21	1,100,287.65

23.	Balance (item 18 minus item 22)	$00.00
24.	Add excess of interest paid on indebtedness incurred for purchase of obligations of United States issued since Sept. 1, 1917 (item E, total of column 6)	00.00
128d 25.	Amount subject to normal tax of 2 per cent under act Oct. 3, 1917	00.00
26.	Less additional exemption	2,000.00
27.	Amount subject to normal tax of 2 per cent under act Sept. 8, 1916	00.00
28.	Normal tax of 2 per cent on amount of item 25	00.00
29.	Additional normal tax of 2 per cent on amount of item 27	00.00
30.	Total normal tax	00.00
31.	Less tax withheld on tax-free-covenant bonds	679.35
32.	Balance of normal tax due	00.00
33.	Surtax	417,620.56
34.	Excess profits tax at rate of 8 per cent	2,520.00
	struction 7, page 1)	2,520.00
35.	Excess profits tax on income from business with invested capital, as computed on excess profits tax return	420,140.56
37.	Additional assessments and penalties	34,918.14
		455,058.70

I swear (or affirm) that this return, including the accompanying schedules (if any), to the best of my knowledge and belief, is a true and complete statement of all taxable gains, profits, and income received by me during the year 1917, and that I am entitled to all deductions and exemptions entered or claimed herein.

JAMES DOUGLAS.

Sworn to and subscribed before me this 28th day of Mar., 1918.

BERTHA M. HUNT,
Notary Public.

128e NOTE.—In addition to the monies received during the year 1917 as reported in the foregoing individual income tax return for 1917, I have received the following amounts:

1917			
Sept.	28.	Rec'd as a stockholder, from the Phelps Dodge Corporation, 99 John St., New York, N. Y., "a distribution from reserve for depletion"	$123,150.00
Dec.	28.	Do	205,250.00
		Total	328,400.00
		The Phelps Dodge Corp., owner and operator of Mines, advised 1/29/17 that these two distributions are distributions of the proceeds of the sale of capital assets in existence March 1, 1913. These amounts are therefore not included in the return.	
Sept.	25.	Rec'd as a stockholder, from the Calumet and Arizona Mining Company, Calumet, Mich., a check paid as a capital distribution of $1.00 per share of stock held	1,165.00
		The Calumet & Arizona Mining Co. advises 1/25/18, that this sum was paid out of reserve for depreciation and reserve for depletion of mines set up in 1915 and 1916.	

Jan.	20.	Rec'd as a stockholder, from the Shattuck-Arizona Copper Co., 120 Broadway, New York, N. Y., a check as a capital distribution No. 1	$75.00	
Apr.	20.	" No. 2	75.00	
July	20.	No. 3	75.00	
Oct.	20.	No. 4	75.00	
		Total		$300.00

On Jan. 25, 1918, the Shattuck-Arizona Copper Co. advises that capital distributions No. 1 and 54.95% of No. 2 were paid from reserves for depletion of mines accumulated during 1916, and the balance of No. 2 and the whole of No. 3, No. 4, and No. 5 (No. 5 pd. in 1918) were paid from like reserves accumulated during 1917.

329,805.00

As these receipts were capital distributions they are not included in the return for 1917.

128f Memorandum of dividends received in the year 1917 from corporations paid from profits accrued in the year 1916, as shown in the total of col. 5 of block "F" on page 3 of income tax return for 1917:

Phelps Dodge Corp., 99 John St., New York		$246,300.00
Old Dominion Co., 50 Congress St., Boston, Mass.		48,720.00
Atch. Top. & Sa. Fe Ry. Co., 32 Nassau St., New York:		
Preferred stock div'd	2102.00	
Common stock div'd	124.56	
		226.56
Great Northern Ry. Co. pref., Nassau St., N. Y.		625.94
United Verde Extension Mining Co., 233 Bdway., N. Y. C.		14,375.00
Bisbee Improvement Co., Bisbee, Ariz.		352.00
Douglas Investment Co., Douglas, Ariz.		875.00
Morenci Water Co., Morenci, Ariz.		875.00
Calumet & Arizona Mining Co.		3,315.00
Internat. Nickel Co., 43 Exchange Pl., N. Y. C.:		
Preferred stock div'd	$375.00	
Common stock div'd	822.00	
		1,197.00
Montana Power Co. pref. st., 42 Bdway, N. Y. C.		262.50
Prescott State Bank, Prescott, Ariz.		510.00
Mississippi Glass Co., common st., 220 Fifth Av., N. Y.		28.00
Cuba Cane Sugar Co., pref. stk., 122 Wall St., N. Y. C.		525.00
American Woolen Co., Boston, Mass.		175.00
Marlin Arms Co. pref. stk., New York, N. Y.		47.84
United Alloy Steel Corp., Canton, Ohio		300.00
Shattuck-Ariz. Copper Co., 120 Broadway, N. Y. C.		50.00
Moline Plow Co., 1st pref. st., Moline, Ill.		350.00
American Bank Note Co., pref. stk., 70 Broad St., N. Y.		180.00
Lehigh Valley R. R. Co., com. st., Philadelphia, Pa.		222.50
Lucky-Tiger Comb. Gold Mng. Co., 1012 Balto. Av., Kansas City		301.50
Independent Corp., 119 W. 40th St., N. Y. Co.		210.00
Total from 1916 profits		319,800.78
In addition the North Star Mines Co., 22 William St., N. Y. C., paid divds. in 1917 from profits accrued in the following years:		
1913		453.00
1914		247.00
1915		225.00
Total amount on which additional assessment is to be paid		320,775.78

129 DEFENDANT'S EXHIBIT 2

CLAIM FOR REFUND

Taxes erroneously or illegally collected; also amounts paid for stamps used in error or excess

STATE OF NEW YORK,
County of New York, ss:

George Notman, Edmund Coffin, and Archibald Douglas, as executors of the estate of James Douglas, deceased, 99 John Street, New York, N. Y.

This deponent being duly sworn according to law deposes and says that this claim is made on behalf of the claimant named above, and that the facts stated below with reference to the claim are true and complete:

1. Business engaged in by claimant executors of decedent's estate.
2. Character of assessment or tax income and excess profits for year 1917.
3. Amount of assessment or stamps, $639,638.42.
4. Amount now asked to be refunded (or such greater amount as is legally refundable), $173,579.72.
5. Date of payment of assessment or purchase of stamps.

Deponent verily believes that the amount stated in item 4
130 should be refunded and claimant now asks and demands refund of said amount for the following reasons:

(The attached statement of seven pages, being too long for insertion here, is hereby made a part of this affidavit, with the same force and effect as though written in this space.)

And this deponent further alleges that the said claimant is not indebted to the United States in any amount whatever, and that no claim has heretofore been presented, except as stated herein, for the refunding of the whole or any part of the amount stated in item 3.

Signed ARCHIBALD DOUGLAS,
GEORGE NOTMAN,
EDMUND COFFIN,
Executors of the estate of James Douglas, deceased.

Sworn to and subscribed before me this 14th day of November, 1919.

EDWARD HOLLOWAY.

Dr. James Douglas, on March 28, 1918, filed with the collector of internal revenue, second district, New York, his income tax statement for the taxable year 1917, in accordance with the provisions of Title I of an act of Congress approved September 8th, 1916, as amended October 3d, 1917 showing a net income subject to
131 tax amounting to $967,855.56 and thereafter duly paid on June 11th, 1918, the tax thereon amounting to $455,058.70. A

copy of the receipt thereof is hereto annexed and marked "Exhibit 1."

To his return there was attached and filed and for the purpose of advising the Treasury Department of the receipt of the amounts therein set forth, a statement as follows:

"NOTE.—In addition to the monies received during the year 1917 as reported in the foregoing individual income tax return for 1917, I have received the following amounts:

1917.			
Sept.	28.	Rec'd, as a stockholder from the Phelps Dodge Corporation, 99 John Street, New York, N. Y., "a distribution from reserve for depletion"	$123,150.00
Dec.	28.	Do	205,250.00
		Total	328,400.00
		The Phelps Dodge Corp., owner and operator of mines, advised 1/29/17, that these two distributions are distributions of the proceeds of the sale of capital assets in existence March 1, 1913. These amounts are therefore not included in the return.	
Sept.	25.	Rec'd, as a stockholder, from the Calumet and Arizona Mining Company, Calumet, Mich., a check paid as a capital distribution of $1.00 per share of stock held	1,105.00
132		The Calumet & Arizona Mining Co. advises, 1/25/18, that this sum was paid out of reserve for depreciation and reserve for depletion of mines set up in 1915 and 1916.	
Jan.	20.	Rec'd as a stockholder from the Shattuck-Arizona Copper Co., 120 Broadway, New York, as a Capital Distribution No. 1	$75.00
Apr.	20.	" " " 2	75.00
July.	20.	" " " 3	75.00
Oct.	20.	" " " 4	75.00
		Total	300.00
		On Jan. 25, 1918, the Shattuck-Arizona Copper Co. advises that Capital Distributions No. 1 and 54.95% of No. 2 were paid from Reserves for Depletion of Mines accumulated during 1916, and the balance of No. 2 and the whole of No. 3, No. 4, and No. 5 (No. 5 pd. in 1918) were paid from like Reserves accumulated during 1917.	
			329,805.00

"As these receipts were capital distributions they are not included in the return for 1917."

Thereafter a letter was received from the Treasury Department, Washington, D. C., dated February 20th, 1919, copy of which is hereto annexed and marked "Exhibit 2," in which letter it was claimed by the said Treasury Department that there was upon
133 investigation an additional tax for the year 1917, amounting to $173,579.72 and giving the following calculation:

1917

Dividends 1913–1915	$915.00	
Dividends 1916	319,860.78	
Gross Income		$1,566,114.09
Deductions		31,883.00

Net income		$1,534,231.09
Less excess profits tax		2,520.00
Total		1,531,711.09
Less contributions		277,873.03
		1,253,838.06
Less 1917 dividends		1,427,987.65
Normal tax	None.	
Super tax	$590,141.22	
Tax on 1915 dividends	54.90	
Tax on 1916 dividends	35,921.67	
Excess profits tax	2,520.00	
Total	628,637.79	
Tax paid	455,058.07	
Additional tax due	173,579.72	

Upon receipt of this letter and through the attorneys of said James Douglas, he inquired from the Treasury Department the reason for this tax, a copy of which inquiry is hereto attached and marked "Exhibit 3," to which the Treasury Department answered on April 22nd, 1919, a copy of which is hereto attached and
134 marked "Exhibit 4," stating with reference to the 1917 income tax as follows:

"The increase to gross income in 1917 of over $329,000 is the result of including as 1917 income the amount claimed as a depletion dividend, and not returned; examination of the accounts of the Phelps Dodge Company, paying this dividend, show a surplus and undivided profit available for such dividend greatly in excess of this amount and which under the law will be deemed to have been paid from such reserve."

This of course refers to the amount received as depletion dividends of which James Douglas advised the department in the statement attached to his return and above set forth. By using the words "by over $329,000" the collector has included the two small items of $1,105 paid as a depletion dividend by the Calumet & Arizona Mining Company and the $300 paid by the Shattuck-Arizona Copper Company.

On June 25th, 1918, Dr. James Douglas died at Spuyten Duyvil, New York. Thereafter his will was duly filed and admitted to probate in the Surrogate's Court of Bronx County on the 22nd day of August, 1918, and George Notman, Edmund Coffin, and Archibald Douglas, above named, were duly appointed his executors.

Thereafter and upon demand and threat of distress by the collector of internal revenue, second district, N. Y., the executors of the estate of said James Douglas, deceased, paid under protest and
135 against their will, the amount of $173,579.73 being the tax levied and assessed on said depletion dividends.

Now, wherefore, the undersigned state that the amount of $328,400 paid by the Phelps Dodge Corporation to the late James Douglas in the year 1917, was not as alleged in the letter of the Treasury Department, dated April 22nd, 1919, a distribution from the sur-

plus or undivided profits of the Phelps Dodge Corporation, but the payment out of reserve for depletion set aside by said Phelps Dodge Corporation in accordance with the income tax law applicable to corporations, and that is was a distribution to the stockholders and to said James Douglas of capital and not income.

The undersigned state that the amount of $1,105 paid by the Calumet and Arizona Mining Company to the late James Douglas in the year 1917 was not a distribution from surplus or undivided profits by the Calumet and Arizona Mining Company, but was a payment out of the reserve for depletion set aside by said corporation in accordance with the sections of the income tax law applicable to corporations, and that it was a distribution to the stockholders and to said James Douglas of capital and not income.

The undersigned state the amount of $300 paid by the Shattuck-Arizona Copper Company to the late James Douglas, in the year 1917, was not a distribution from the surplus or undivided profits of the Shattuck-Arizona Copper Company, but was a payment out of the reserve for depletion set aside by said corporation in accordance with the provisions of sections of the income tax
136 law applicable to corporation, and that it was a distribution to the stockholders and to the said James Douglas of capital and not income.

That the levy on the part of the Treasury Department of the income tax on the sum of $329,700 is an attempt to levy a direct tax upon the capital or property of the late James Douglas, but without apportionment among the States in proportion to the population as required by subdivision 4, section 9 of article 1 of the Constitution of the United States. That said levying of a tax on the said $329,700 is an attempt to tax as income what was in fact capital or property of the said late James Douglas and not income within the provisions of article 16 of the Constitution of the United States.

That the said tile 1 of the act of September 8th, 1916, as amended by the law of October 3, 1917, and in particular sec. 31 thereof, as so construed and applied by the Treasury Department in respect to the levying of the said tax on said $329,700 is an attempt to levy a tax upon income which had accrued or been earned before March 1st, 1913, and contrary to the sixteenth amendment of the Constitution of the United States.

That the said title 1 of the act of September 8, 1916, as amended by the law of October 3, 1917, and in particular sec. 31 thereof, as so construed and applied by the Treasury Department in respect to the levying of the said tax on said $329,700 is an attempt to levy a tax upon the capital or property of the late James Douglas owned by him before March 1st, 1913, and therefore contrary to the provisions of the Constitution of the United States.

137 That the said tile of said acts of Congress make, in respect of said tax, arbitrary and unreasonable discriminations, exceptions, exemptions, and classifications, in violation of fundamental requirements of the Constitution of the United States,

and the requirement therein that taxes shall be uniform throughout the United States.

In sundry other particulars, both in form and substance, the said act of Congress purporting to impose said tax, and the rules and regulations promulgated in connection therewith by the Commissioner of Internal Revenue or the Secretary of the Treasury, and the demand and requirement to make said return and pay said sum, are all and each of them illegal and unconstitutional, and notice is hereby given that in such time and in such manner as may be advisable, appropriate proceedings including any action in law or in equity that may be deemed constitutional, will be taken against you by any and all parties in interest in said sum and to preserve and protect all our rights and interest thereunto appertaining.

Wherefore, the undersigned demand that the sum of $173,579.72 paid under duress and under protest and illegally assessed, be refunded and paid back to the said executors above named.

Nothing in this claim shall be construed as an admission, waiver, or surrender of any rights that the undersigned or anyone interested in the estate may have.

138 EXHIBIT 1 (ATTACHED TO CLAIM FOR REFUND)

Form 1108

United States Internal Revenue. Memorandum for taxpayer—Income and excess profits tax for 1917

INSTRUCTIONS TO TAXPAYER

Detach this part of the form and retain it as a record of the payment of your tax unless you want a receipt other than the endorsement on your check. If a receipt is desired forward this part of the form and the notice with your remittance. Otherwise no receipt will be issued.

2414831 James
Douglas
99 John St.
New York, N. Y. $455058.70

TAXPAYER'S RECORD

Check No. ---------- Money order No. ----------

Office of issue

Bank----------

Date---------- Date----------

(Stamp)

Income tax

Excess profits tax

Total

Office of the collector of Internal revenue 2nd district

June 11, 1918
Receipt

EXHIBIT 2 (ATTACHED TO CLAIM FOR REFUND)

IT:RAA:P—SC

TREASURY DEPARTMENT,
Washington, Feb. 20, 1919.

DOUGLAS, ARMITAGE & MCCANN,
Woolworth Building, 233 Broadway, New York, N. Y.

SIRS: An investigation of the income tax liability of the
139 late James Douglas, 99 John Street, New York City, N. Y., for the years 1915 to 1917, inclusive, based on a revenue

agent's report and an audit in this office, indicates that there are further taxes due of $85.19 for the year 1915, $1,059.01 for 1916 and $173,579.72 for 1917.

The amended returns should read as follows:

1915

Gross income		$1,201,836.98
General deductions		81,268.20
Net income		1,120,568.78
Dividends	$1,071,257.37	
At source	89,176.42	
Exemption	4,000.00	
Total		1,164,433.79
Normal tax	None.	
Additional tax	57,284.12	
Tax previously paid	57,198.93	
Additional tax due	85.19	

1916

Gross income		1,899,675.99
General deductions		110,268.81
Net income		1,789,407.18
Dividends	1,757,561.97	
Exemption	4,000.00	
Total		1,761,561.97
Income subject to normal tax		27,845.21
140 Normal tax	566.90	
Super tax	172,728.86	
Total tax due	173,285.76	
Tax paid	172,226.66	
Additional tax due	1,059.10	

1917

Dividends 1913–1915	915.00	
Dividends 1916	319,860.78	
Gross income		1,566,114.09
Deductions		31,883.00
Net income		1,534,231.09
Less excess profits tax		2,520.00
Total		1,531,711.09
Less contributions		277,873.03
		1,253,838.06
Less 1917 dividends		1,427,987.65
Normal tax	None.	
Super tax	590,141.22	
Tax on 1915 dividends	54.90	
Tax on 1916 dividends	35,921.67	
Excess profits tax	2,520.00	
Total	628,637.79	
Tax paid	455,058.07	
Additional tax due	173,579.72	

141 Assessment of the above amounts will be made on the next list sent to the collector of your district.

Respectfully,

HOWARD H. PACE,
Acting Deputy Commissioner.

EXHIBIT 3 (ATTACHED TO CLAIM FOR REFUND)

FEBRUARY 28, 1919.

COMMISSIONER INTERNAL REVENUE,
Treasury Department, Washington, D. C.

Estate James Douglas

DEAR SIR: Referring to your letter of February 20, 1919, marked IT:RAA:PSC, relating to the income tax returns of James Douglas for the taxable years 1915, 1916, and 1917, will you kindly advise us of the reason of your reduction in the general deductions in the income tax statement for 1915 from $82,688.20 to $81,268.20, resulting in an additional tax of $85.19. We wish to know what items you have disallowed and the reason.

Referring to the 1916 returns, will you kindly advise us of the reason for the reduction in the general deductions from $114,453.81 to $110,268.81.

Referring to the 1917 return, will you kindly advise us why the gross income has been increased by $329,700 and the general deductions reduced by $6,700.

142 We will greatly appreciate an immediate reply to our inquiry in order that we may be apprised before bills are sent us by the collector of New York.

Yours very truly,

DOUGLAS, ARMITAGE & MCCANN,
By EDWARD HOLLOWAY.

EH/P

EXHIBIT 4 (ATTACHED TO CLAIM FOR REFUND)

TREASURY DEPARTMENT,
Washington, Apr. 23, 1919.

IT:IA:RAA:P

DOUGLAS, ARMITAGE & MCCANN,
Woolworth Bldg., 233 Broadway, New York, N. Y.

SIRS: This office is in receipt of your letters of February 28 and April 1, 1919, relative to further tax found due on the income of the late James Douglas as based upon the report of a revenue agent and an audit by this office, as advised in office letter of February 20, 1919.

In reply you are advised that the general deductions for 1915 were reduced to $1,420 through disallowance of excess depreciation claimed, the taxpayer having included for this purpose the value

of the land as well as the improvements. The general deduc-
143 tions for 1916 were reduced $4,185 by the disallowance of $2,235.00 losses claimed because the same were not incurred in trade and no income from similar sources was returned. As in 1915, depreciation was reduced to $300.00, a fair allowance upon the property involved, a disallowance of $1,950 on the amount claimed.

The increase of gross income in 1917 by over $329,000 is the result of including as 1917 income the amount claimed as a depletion dividend, and not returned, examination of the accounts of the Phelps Dodge Co., paying this dividend, showing a surplus and undivided profit available for such dividend greatly in excess of this amount and which under the law will be deemed to have been paid from such reserve.

J. H. CALLAN,
Assistant to the Commissioner.

EXHIBIT 5 (ATTACHED TO CLAIM FOR REFUND)

Letter of Protest filed with payment of tax. Printed in full on page 20 et seq.

144 EXHIBIT 6 (ATTACHED TO CLAIM FOR REFUND)

Form 1–17b—Revised, MAY 5, 1919.

United States Internal Revenue. Demand for payment of income and excess profits tax for 1917

OFFICE COLLECTOR OF INTERNAL REVENUE,
2nd Dist., Custom House, N. Y.

Demand is hereby made for the amount of income and excess profits tax stated opposite your name. Failure to pay this tax on or before the due date given below will cause a 5 per cent penalty to accrue with interest at 1 per cent per month from the due date until paid.

WM. H. EDWARDS,
Collector of Internal Revenue.

Wash. List. Jan. 1919, F–6 L–13
2414831—1917

James Douglas, 99 John St. $173,579.72. Date due, May 16, 1919.

This part of the form must be sent to the collector with remittance. Disregard previous notices.

145 In United States District Court

Stipulation settling bill of exceptions

It is stipulated that the foregoing bill of exceptions contains all the evidence, exhibits, rulings of the court, and exceptions upon the

trial of this action and may be settled, order to be filed, and annexed to the judgment roll herein.

New York, May 14, 1923.

DOUGLAS, ARMITAGE & MCCANN,
Attorneys for Plaintiffs.
WM. HAYWARD,
U. S. Attorney, Attorney for Defendant.

In United States District Court

Order settling bill of exceptions

Upon the above stipulation the foregoing bill of exceptions, containing all the evidence, exhibits, rulings of the court and exceptions upon the trial of this action, is hereby settled and ordered on file.

May 14, 1923.

JULIAN W. MACK,
United States District Judge.

146 In United States District Court

Order allowing writ of errors

[Title omitted.]

Considering the foregoing petition this day presented, it is

Ordered that writ of error be allowed to Archibald Douglas, George Notman, and Edmund Coffin as executors of the estate of James Douglas, deceased, the petitioners and plaintiffs in this suit, from the judgment and decree of December 22, 1922, rendered against plaintiffs in the above entitled cause, and that said appeal shall be returnable to the United States Circuit Court of Appeals for the Second Circuit, and that upon the execution of a bond in the penalty of $250.00 said appeal shall operate as a supersedeas of said decree and shall suspend until the final decree on appeal herein the effect of the judgment herein, and that a transcript of a record, including all of the exhibits offered in evidence by either party be filed in the United States Circuit Court of Appeals according to law as prayed for.

Dated, May 15, 1923.

HENRY W. GODDARD,
Judge of the U. S. Dist. Court.

147 In United States District Court

Petition for writ of errors

[Title omitted.]

The petition of the plaintiffs, by their attorneys, Douglas, Armitage & McCann, herein respectively presents:

The petitioners are aggrieved by the judgment and decrees herein rendered, on the twenty-second day of December, 1922, in favor of

the defendant and against the complainant, dismissing the plaintiff's complaint and directing judgment for $21.15 costs, and that the plaintiffs have execution therefor, and that the petitioners for the reason specified in the assignment of errors filed herewith desire to appeal from said judgment and decree, and desire that said appeal, returnable to the Circuit Court of Appeals of the Second Circuit, shall operate as supersedeas and may suspend during the pendency of said appeal the execution of the said judgment.

148 Wherefore, your petitioners pray that the said appeal may be allowed and that upon giving bond in an amount to be fixed by this court the said appeal may operate as a supersedeas and may suspend during the pendency of the said appeal the execution of the said judgment; that said appeal be made returnable to the United States Circuit Court of Appeals for the Second Circuit, according to law, and that a transcript of the records, proceedings, papers, and exhibits upon which said decree was rendered, duly authenticated, be sent to said Circuit Court of Appeals.

Dated, May 15, 1923.

DOUGLAS, ARMITAGE & MCCANN,
Attorneys for the Plaintiffs,
233 Broadway, New York, N. Y.

149 In United States district court

Assignment of errors

[Title omitted.]

And now on the 11th day of May, 1923, came the said plaintiffs, by Douglas, Armitage & McCann, their attorneys, and say:

That the judgment and decree in said cause is erroneous and against the just rights of said plaintiffs for the following reasons:

1. That the court erred in refusing to direct a verdict for the plaintiffs for $173,579.72, with interest and costs.

2. That the court erred in refusing to direct a verdict for the plaintiffs.

3. That the court erred in directing a verdict for the defendant.

4. That the court erred in holding and deciding that the claim for refund "was properly rejected."

150 5. That the court erred in holding and deciding that the word "distribution," as used in section 31–a and 31–b of the revenue act of 1916, as amended in 1917, referred solely to dividends in the ordinary courses of business.

6. That the distributions in question were liquidating dividends specifically declared and made from a depletion reserve based upon the March 1, 1913, value of the Phelps Dodge Corporation's mines, which reserves were set up under the direction of and in accordance with the regulations of the Treasury Department and made up of the proceeds from the sale of capital assets owned on March 1, 1913.

7. That the court erred in failing and refusing to find that the dividends constituted a return of capital to the stockholders.

8. That the court erred in failing and refusing to find that the directors in each of these years believed they were paying dividends out of the company's net income inasmuch as the depletion was taken on the books of the company at a considerably less amount than that ultimately allowed by the Government on March 2, 1920.

9. That the court erred in refusing to find that the total distributions to the stockholders of the Phelps Dodge Corporation
151 during the years 1913 to 1917, inclusive, exceeded the net income of those years as computed by the Government, by the amount of $1,616,000.00.

10. That the court erred in refusing to find that in no circumstances can Mr. Douglas's share of $1,616,000.00 of the amount distributed as depletion dividends in 1917 be regarded as taxable income accruing subsequent to March 1, 1913.

11. That the court erred in holding and deciding that any part of the dividends that were paid by the Phelps Dodge Corporation in the years 1913, 1914, or 1915, came from the surplus that had accrued, accumulated since March 1, 1913, or the depletion reserve that had been set aside based on the value of March 1, 1913.

12. That the court erred in holding and deciding that distributions to shareholders in the year 1917, are to be regarded as made from current earnings and not the most recently accumulated surplus, set up on the books of Phelps Dodge Corporation, and in failing to find that the Phelps Dodge Corporation 1917 distributions were from the surplus so ascertained and set up as of December 31, 1916.

13. That the court erred in failing and refusing to find that "the most recently accumulated undivided profits or surplus" in section 31–b of the revenue act of 1916 as amended, is limited to such
152 profits and surplus as are definitely ascertained by closing the books.

14. The court erred in finding that Congress did not intend to use the terms "most recently accumulated undivided profits or surplus" in section 31–b of the act of 1916 as amended by the act of 1917, in a strict technical sense which would exclude from their embrace current profits.

15. That the court erred in finding that Congress in the subsequent legislation in the revenue acts of 1918 and 1921 in substituting for the words "most recently accumulated undivided profits or surplus," the word "earnings" in the section corresponding to section 31–b intended not a change but a mere clarification of the law.

16. The court erred in finding that depletion distributions without a corresponding reduction of capital stock are not to be differentiated in the matters here under consideration from ordinary dividends.

17. The court erred in finding that depletion reserve account is a mere bookkeeping account and that any distributions purporting to come therefrom are from the general assets of the company.

18. That the court erred in finding the revenue act of 1916, as amended, correctly interpreted by paragraph 26 of Regulations 33.

19. That the court erred in failing and refusing to find
153 that $147,415.11 of the Phelps Dodge distributions paid to Mr. Douglas in 1917 was a true depletion or capital payment and free from tax.

20. That the court erred in finding that the amounts deducted for depletion from the annual receipts of mining companies are "earnings or profits," as those words are used in section 31–b of the act of 1916 as amended by the act of 1917.

21. That the court erred in failing and refusing to find that sound business principles require that in arriving at "earnings or profits" of wasting industries, depletion be deducted in order to preserve capital intact.

22. That the court erred in failing and refusing to find that the doctrine of Lynch v. Hornby, 247 U. S. 339, does not apply to a specific distribution from a depletion reserve, accrued prior to March 1, 1913, but realized subsequent thereto.

23. That the court erred in failing and refusing to find that such distribution is an extraordinary or liquidating dividend and is a return of capital to the stockholders, tax exempt under the doctrine of Lynch v. Turrish, 247 U. S. 221.

24. That the court erred in failing and refusing to find that under the definition of dividend contained in the act of 1916, section 2–a, and repeated in section 31–a of the act of 1917 limiting such distributions to "earnings or profits accrued since March 1,
154 1913," the two distributions in question are not dividends as defined, but are distributions from depletion reserve and are not taxable income within the law.

25. That the court erred in holding and finding that section 31–b applied to and covered a distribution out of earnings and profits accumulated before March 1, 1913, or increase in value accrued before March 1, 1913, which was, in fact, a distribution of capital assets and in holding that section 31–b, if so construed, was not an attempt to levy a tax on capital without apportionment among the States according to population, according to Article I, section 4 of the Constitution.

26. That the court erred in holding that the word "deemed" in said section 31–b raised an irrebuttable presumption and thereby precluded the taxpayer and the plaintiffs from showing that the distributions in question in this case were in fact made from a capital reserve or fund, and thus gave to the law a construction which made it a direct or capital tax or levy in violation of section 4 of Article I of the Constitution of the United States, as not being apportionment among the States according to population.

27. That the court erred in failing and refusing to find that section 31-b has no application whatever to a distribution out of anything other than a surplus or undivided profits account accumulated out of earnings since March 1, 1913.

155 28. That the court erred in failing and refusing to find that section 31-b does not apply to liquidating distributions from a depletion reserve, by law a fund made up of deductions from receipts before net income was fixed.

29. That the court erred in failing and refusing to find that the word "deemed" as used in 31-b merely raises a rebuttable presumption that 1917 distributions were made from the most recently accumulated undivided profits and surplus.

30. That the court erred in failing and refusing to find that the action of the corporation in this case rebuts the presumption raised by section 31-b and establishes that these dividends were paid out of capital assets.

31. That the court erred in failing and refusing to find that section 31-b is illegal and void in its attempt to penalize the innocent stockholder for the disobedience of the law by the directors of the corporation.

32. That the court erred in failing and refusing to find that section 31-b, if construed retroactively, is unconstitutional and void under the fifth amendment as a denial to the stockholder of due process of law.

33. That the court erred in failing and refusing to find that the capricious and arbitrary classification in section 31-b, making

156 distributions from either the earnings or profits accumulated before March 1, 1913, or from depletion reserve based thereon, prior to "August 6, 1917," free from tax, and such distributions after such date taxable, is unconstitutional under the fifth amendment.

34. That the court erred in failing and refusing to find that the words "most recently accumulated undivided profits or surplus," as used in the act of 1917, section 31-b, refer to the "undivided profits and surplus account" as shown by the books to have accumulated prior to the close of the last fiscal period.

35. That the court erred in failing and refusing to find that the words "most recently accumulated undivided profits or surplus," as used in section 31-b of the revenue act of 1916 as amended by the revenue act of 1917, do not and did not include or refer to the current earnings of the year 1917.

36. That the court erred in entering judgment for the defendant.

37. That the court erred in dismissing the complaint herein upon the merits.

Wherefore, the said plaintiffs pray that the said judgment be reversed and that the said court may be directed to enter a judgment in accordance with the prayer of the bill.

DOUGLAS, ARMITAGE & MCCANN,
Attorneys for the Plaintiffs,
233 Broadway, New York, N. Y.

157 In United States District Court

Stipulation for supersedeas bond

[Title omitted.]

It is stipulated and agreed by and between the attorneys for the respective parties hereto that the amount of cost and supersedeas bond of the plaintiffs above named on the writ of error herein to the United States Circuit Court of Appeals for the Second Circuit be fixed at two hundred and fifty ($250) dollars and that an order may be entered hereon in accordance herewith, without further notice to either party as against the other.

Dated, May 15, 1923.

DOUGLAS, ARMITAGE & MCCANN,
Attorneys for Plaintiffs.

WM. HAYWARD,
U. S. Attorney, Attorney for Defendant.

(A supersedeas bond by Archibald Douglas, George Notman, and Edmund Coffin, as executors of the estate of James Douglas, deceased, as principals, and the Maryland Casualty Company, as surety, in the sum of two hundred and fifty ($250) dollars, approved by Hon. Henry W. Goddard, United States district judge, was duly filed on May 15, 1923.)

158 [Citation in usual form omitted in printing.]

159 In United States Circuit Court of Appeals

Order extending time

[Title omitted.]

Upon the annexed affidavit of Edward Holloway, verified the 12th day of June, 1923, and the annexed consent of William Hayward, U. S. attorney, attorney for the defendant in error,

Now, on motion of Douglas, Armitage & McCann, attorneys for the plaintiffs in error, it is

Ordered that the time of the plaintiffs in error within which to docket case and file the record be, and the same hereby is, extended to and including the 15th day of July, 1923.

JULIAN W. MACK,
Judge, U. S. Circuit Court of Appeals.

160 In United States District Court

Stipulation re transcript of record

[Title omitted.]

It is hereby stipulated that the foregoing and all of the same is a true transcript of the record in the above-entitled cause and that the same may be so certified by the clerk and filed herein.

Dated New York, July 14, 1923.

DOUGLAS, ARMITAGE & MCCANN,
Attorneys for Plaintiffs.

WM. HAYWARD,
U. S. Attorney, Attorney for Defendant.

161 In United States District Court

Clerk's certificate

[Title omitted.]

I, Alexander Gilchrist, jr., clerk of the District Court of the United States of America for the Southern District of New York, do hereby certify that the foregoing is a correct transcript of the record of the said District Court in the above-entitled matter as agreed on by the parties.

In testimony whereof, I have caused the seal of the said court to be hereunto affixed at the city of New York, in the Southern District of New York, this ——— day of ———, in the year of Our Lord one thousand nine hundred and twenty-three, and of the independence of the United States the one hundred and forty-eighth.

ALEXANDER GILCHRIST, JR., *Clerk.*

162 In United States Circuit Court of Appeals for the Second Circuit

No. 95—October term, 1923

Argued November 15, 1923. Decided April 7, 1924.

ARCHIBALD DOUGLAS, GEORGE NOTMAN AND Edmund Coffin, as Executors of the Estate of James Douglas, deceased, plaintiffs-in-error (plaintiffs below) v. WILLIAM H. EDWARDS, COLLECTOR OF UNITED States internal revenue for the second district of the State of New York, defendant-in-error (defendant below)	In error to the District Court of the United States for the Southern District of New York

Before Rogers, Manton and Mayer, circuit judges.

Opinion

Writ of error to a judgment of the District Court for the Southern District of New York entered on a directed verdict in favor of defendant, dismissing the complaint and awarding costs against plaintiffs to defendant.

The facts having been stipulated, only questions of law were in controversy and each side, therefore, moved for the direction of a verdict with the result supra.

The action was brought to recover $173,579.72 additional income tax for 1917, paid under protest by plaintiffs to defendant collector.

163 A claim for refund was duly made and denied.

The additional tax was levied on two-called depletion distributions made in September and December, 1917, by Phelps, Dodge

Corporation, a mining company and received in his lifetime by James Douglas, a stockholder.

It is contended by plaintiffs that these dividends were not income and, therefore, not taxable or, if income and taxable, then not at the 1917 rate, while defendant insists that the dividends were taxable as income and at the 1917 rate.

Phelps, Dodge & Co., Inc., was organized under the laws of New York on December 14, 1908, with an authorized capital stock of $50,000,000, divided into 500,000 shares of the par value of $100 each. $45,000,000 par value was issued for $90,000,000 of assets of which $66,000,000 represented copper and coal mines and $24,000,000 other assets.

The corporation thus had a capital stock of $45,000,000 and a paid-in surplus of $45,000,000.

These assets were held by various subsidiary companies but the history and relation of these companies need not be recited as the parties agree that these antecedent details do not affect the controversy.

By March 1, 1913, the assets of the corporation had increased in value to $153,275,606.69 of which $132,285,000 represented the value of its mines and the balance represented the plant investments and other current assets.

On March 1, 1913, Douglas held 41,025 shares of the capital stock of Phelps, Dodge & Co. Inc.; on July 2, 1913, he purchased 25 additional shares of such stock. He held this stock until April 1, 1917, when in the reorganization infra he exchanged his 41,050 shares in Phelps, Dodge & Co., Inc., for 41,050 shares in Phelps, Dodge Corporation, which shares he held continuously until his death on June 25, 1918.

164 On April 1, 1917, the business was reorganized in a manner not material to the issues here involved, and Phelps, Dodge Corporation (hereinafter called Phelps Co.), became the name of the reorganized company and became the parent company. For brevity and convenience, Phelps Co. will be understood to refer to the present and previous corporations.

From 1913 to 1917, inclusive, the mines owned by Phelps Co. were operated and the product sold and in each year a certain amount was deducted from gross income and credited on the books of the company to a depletion reserve account to make good the wastage caused by the operation of the mines.

In 1918, Phelps Co. filed its income and excess profits tax returns for the year 1917.

On December 1, 1919, the Commissioner of Internal Revenue made a provisional valuation for depletion and other purposes of the various mining properties owned as of March 1, 1913. It was held that Phelps Co. had an outstanding capital stock of $45,000,000, a paid-in surplus of $45,000,000, and the "total value fixed by the bureau as of March 1, 1913" of all the company's mines was $132,285,000.

Upon the basis of the foregoing valuation the income and excess profits tax returns of Phelps Co. for the years 1917 and 1918 were audited and closed by the Commissioner of Internal Revenue and the tax paid.

These taxes of the corporation were adjusted to make them correspond with the revised depletion figures. Phelps Co. had set up on its books a depletion reserve from 1913 to 1917, inclusive, which for these years aggregated $14,416,783.88. This depletion reserve was revised by the Commissioner of Internal Revenue and increased for this period to $25,837,427.91. The summary memorandum of the changes in financial conditions of Phelps Co. from 1912 to 1917 is noted in the margin for convenient reference.

165 [Plaintiff's Exhibit D. Phelps Dodge Corporation memorandum re changes in financial condition, 1912–1917, omitted. Printed side page 32p ante.]

166 In 1913 after deducting the depletion fixed by the Commissioner of Internal Revenue, Phelps Co. earned a net profit of $6,373,116.86. Total distributions to stockholders in 1917 aggregated $7,425,000 or $1,051,883.14 more than its net profit. Obviously, this excess must have been paid out of surplus which it had on hand at the beginning of the year, i. e., surplus accumulated prior to March 1, 1913, since there was no other fund from which it could have been paid. The result was that the surplus at the end of 1913 decreased from $108,275,606.79 to $107,223,723.55 or by $1,050,883.14, the exact amount by which the distributions paid to stockholders exceeded the profits.

By following Exhibit D, it will be noted that by the end of 1915, Phelps Co. had paid out of its profits since March 1, 1913, and in addition, out of surplus accumulated prior to that date, a sum aggregating $7,084,901.15, the amount by which the distributions paid in 1913, 1914, and 1915 exceeded the amount of profits earned in those years.

In 1916, the situation changed. In that year, the company earned a net profit of $17,750,621.67 over its depletion deduction and paid dividends amounting to $14,625,000. It, therefore, had an excess of profits over dividends of $3,125,621.67.

In 1917, the company earned net profits of $16,742,487.06 and paid regular dividends of $10,800,000. At a meeting of the board of directors of the company, on September 13, 1917, the company passed a resolution which recited that it had yearly in computing its income deducted therefrom a reasonable allowance for depletion of its mines based upon the fair market value thereof as of March 1, 1913, and that the statutes and department rulings provided for a separation of these deductions from income and that payments to stockholders from the depletion account would be a return of capital invested and not subject to income tax in the hands of the shareholders and thereupon it resolved:

167 "That this company distribute among its stockholders from said depletion account, three dollars a share, to be paid

on September 28, 1917, to stockholders of record on September 24, 1917, the total amount so paid to be deducted from said depletion account."

In December, 1917, a similar resolution was passed, this time, however, distributing $5.00 per share to the stockholders.

The total distribution of these so-called depletion dividends aggregated $3,600,000 and the amounts received by Douglas were, respectively, $123,150 and $205,250, or a total of $328,400.

The return of Phelps Co. for the year 1917 was audited on or about March 2, 1920, and the 1917 income and excess profit taxes of Phelps Co. were finally determined on or about that date.

Douglas in his 1917 income tax return included in his taxable income all dividends received from Phelps Co. except the two so-called depletion dividends of September 28th and December 28th, 1917. He inserted, however, in making up his return a note showing the receipt of these so-called depletion dividends. It was upon this sum of $328,400 that the Commissioner of Internal Revenue assessed an additional income tax and this was the additional income tax paid to defendant by the executors of Douglas on May 16, 1919, which is the subject matter of this controversy. It will also be observed that the income for 1917 before deducting depletion was $22,456,906.32. After deducting the sum of $5,714,419.26, the amount of depletion at Treasury Department rates, the remainder upon that basis representing the earnings or profits for 1917 was the sum of $16,742,487.06. Adding together the total of dividends stated in Exhibit D to have been paid from earned surplus, i. e., $10,800,000 to the sum of $3,600,000, being the amount of so-called depletion distributions; the total is $14,400,000. Deducting this
168 last named amount from the sum of $16,742,487.06 supra, there still remained a balance of 1917 earnings of $2,342,487.06.

Certain amounts were set up by the corporation on its books contemporaneously with the declaration and payment of the so-called depletion dividends and various entries made.

The statute particularly requiring construction reads as follows:

"SEC. 31 (a). That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, * * * out of its *earnings or profits accrued since March first, nineteen hundred and thirteen*, and payable to its shareholders, whether in cash or in stock of the corporation, * * * which stock dividend shall be considered income, to the amount of the *earnings or profits* so distributed.

SEC. 31 (b). Any distribution made to the shareholders or members of a corporation, * * * in the year nineteen hundred and seventeen, or subsequent tax years, *shall be deemed* to have been made from the *most recently accumulated undivided profits or surplus*, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which

such profits or surplus *were accumulated* by the corporation * * * but nothing herein shall be construed as taxing any *earnings or profits accrued prior to* March first, nineteen hundred and thirteen, but *such earnings or profits* may be distributed in stock dividends or otherwise, exempt from the tax, *after* the distribution of *earnings and profits accrued since* March first, nineteen hundred and thirteen has been made. This subdivision shall not apply to
169 any distribution made prior to August sixth, nineteen hundred and seventeen, out of *earnings or profits accrued* prior to March first, nineteen hundred and thirteen." (40 Stat. L., 337, 338. Italics ours.)

Douglas, Armitage & McCann (Matthew C. Fleming, Archibald Douglas, Paul Armitage, and Edward Holloway, of counsel), for plaintiffs in error. William Hayward, United States attorney (Richard S. Holmes, special asst. U. S. attorney, of counsel), for defendant in error. George E. Holmes (Randolph E. Paul and Donald Havens, of counsel), amicus curiae.

MAYER, circuit judge: We have not considered it necessary to set forth the details of various entries and accounts as they were made and carried on the books of Phelps Co. and in respect of which counsel have presented various arguments.

There is no question of good faith in regard to these entries; but it is well at the outset to realize that, in this case, the rights of the parties can neither be established nor impaired by the bookkeeping methods employed or by the names given to the various items. Whether something is capital or income and to what year dividends should be allocated depends partly upon the subject matter and partly upon the statute involved when construed in the light of constitutional requirements.

1. The first contention is that the two so-called depletion distributions were of capital to the stockholders and hence not taxable under the sixteenth amendment of the Constitution of the United States.

170 On March 1, 1913, Douglas owned 41,025 shares of Phelps Co. On July 2, 1913, he acquired 25 more shares. These 41,050 shares he owned in 1917 when he received his proportion upon the distribution of the so-called depletion dividends.

Plaintiffs insist that the fund set aside from time to time for the depletion reserve was capital. There is no controversy as to the various amounts under this head set forth in plaintiff's Exhibit D because they are not mere arbitrary entries by Phelps Co.; but they have been audited and determined by the appropriate department of the Government.

The assertion of plaintiffs, briefly stated, is that the two depletion distributions were a partial realization of an investment made by Douglas years prior to 1917 and represented the gradual increase which had arisen before the effective date of the sixteenth amendment and thus were not taxable as income, gains, or profits. De-

fendant necessarily concedes that, if these distributions were a return of capital, then they were not income of the stockholder Douglas and hence not taxable. Counsel have indulged in arguments somewhat elaborate and have sought to fortify them by references to books on accounting and discussions in respect of the distinctions between capital and income. We need not, however, be led into these controversial paths; for the determination of this question rests upon the understanding of two cases decided by the Supreme Court of the United States, argued at the same time and decided on the same day.

In Lynch v. Turrish, 247 U. S. 221, there was a complete liquidation and winding up. The property of the corporation there concerned had increased in market value with the result that the market value of its shares had increased to twice par value by March 1, 1913. Later, the company sold all its property and made final distribution of the proceeds to the shareholders on surrender of
171 their certificates of stock. The amount thus received by each shareholder was twice the par value of his shares; but represented no increase since the effective date of the act of October 3, 1913, 38 Stat., 166. The Supreme Court held that the value thus received was not "income, gains or profits" of the shareholders subject to the tax.

In Lynch v. Hornby, 247 U. S. 339, it appeared that Hornby from 1906 to 1915 was the owner of 434 shares of the capital stock of a lumber company. On or prior to March 1, 1913, owing to the increase in value of the timber lands of this company and through its business operations, the property had greatly increased in value and Hornby's stock had become worth nearly four times its par value. In 1914, the company distributed dividends aggregating $650,000, of which $240,000, or 24 % of the par value of the capital stock was derived from current earnings and $410,000 from conversion into money of property that it owned or in which it had an interest on March 1, 1913. Hornby's share of the latter amount was $17,794, and this was the amount which was the subject matter of the suit.

Mr. Justice Pitney, writing for the court, definitely distinguished the case from the Turrish case, supra, calling attention to the fact that in the latter case there was a single and final dividend received by Turrish in liquidation of the entire assets of the business of the company of which he was a shareholder and thus a return to him of the value of his stock upon the surrender of his entire interest in the company at a price which represented its intrinsic value at and before March 1, 1913, when the then income tax took effect.

In the Hornby case, there was no winding up or liquidation nor any surrender of Hornby's stock. The court pointed out the difference between a stockholder's undivided share in the profits of a corporation prior to the declaration of a dividend and his participation in the dividends declared and paid, as follows:

172 "It is evident that Congress intended to draw and did draw a distinction between a stockholder's undivided share

or interest in the gains and profits of a corporation, prior to the declaration of a dividend, and his participation in the dividends declared and paid; treating the latter, in ordinary circumstances, as a part of his income for the purposes of the surtax, and not regarding the former as taxable income unless fraudulently accumulated for the purpose of evading the tax. * * *

The stockholder is, in the ordinary case, a different entity from the corporation, and Congress was at liberty to treat the dividends as coming to him ab extra, and as constituting a part of his income when they come to hand."

In concluding the opinion the court said: "Lynch v. Turrish and Southern Pacific C. v. Lowe, rest upon their special facts and are plainly distinguishable." Prior to and after the Turrish and Hornby cases, the Supreme Court had occasion to consider, upon other facts and other provisions of statute law, what was capital and what taxable income and in what respects there were certain distinctions between a corporation and its stockholders. Some of these cases were Collector v. Hubbard, 12 Wall. 1; Bailey v. Railroad Company, 22 Wall. 604 and also 106 U. S. 109; Gray v. Darlington, 15 Wall. 63; Merchants' L. & T. Co. v. Smietanka, 255 U. S. 509; Eldorado Coal Co. v. Mager, 255 U. S. 522; Walsh v. Brewster, 255 U. S. 536. See also opinion of Lowell, D. J., in Merchant's Ins. Co. v. McCartney, 17 Fed. Cas., 46, a case arising out of the act of June 30, 1864, 13 Stat. L., 281.

After examination of these and other cases, we are unable to distinguish the case at bar from the Hornby case. Much is made by plaintiffs in error of expressions used in the Hornby case, to
173 the effect that the dividends in question were "received in the ordinary course by a stockholder from a corporation" and were declared and paid "in the ordinary course of business." As we read the Hornby case, these expressions were clearly explained by the context, for the court said that though these dividends were extraordinary in amount and "might appear upon analysis to be a mere realization in possession of an inchoate and contingent interest that the stockholder had in a surplus of corporate assets previously existing"; yet they were taxable. The court also, in using the expression as to "ordinary course of business" was plainly distinguishing the Hornby case from other cases some of which were contemporaneously decided where there was a different situation than the mere declaration of a dividend or analagous distribution. In the Turrish case, as has been stated, there was a final liquidation. In Southern Pacific Co. v. Lowe, 247 U. S. 330, there was, inter alia, a question of real as contrasted with technical ownership. In Peabody v. Eisner, 247 U. S. 347, the question was whether a dividend by a corporation of shares owned by it in another corporation was a stock dividend.

On this branch of the case at bar, therefore, we think the question argued is ruled by authority and, for that reason, further discussion seems unnecessary.

2. The question which arises under section 31(b) of the act of 1917, passed October 3, 1917, is whether Douglas should have been taxed at the 1917 rate or at the rate prevailing in some year prior to 1917. The controversy revolves around the meaning of the expression "most recently accumulated undivided profits or surplus." There is also a difference of opinion as to the meaning of the word "deemed."

We may dispose at the outset of the meaning of "deemed." If it had been intended that this word should mean a rebuttable and not a conclusive presumption, the word "presumed" could
174 readily have been used and that is a word which is very familiar in many statutes. "Deemed" and its synonym "regarded," according to definitions in cases and dictionaries is the equivalent of "considered" or "adjudged." Leonard v. Grant, 5 F. R. 11, 16; U. S. v. Doherty, 27 F. R. 730, 734; Michel v. Nunn, 101 F. R. 423; Cardinary v. Smith, 5 Fed. Cas. 45, 47; Walton v. Cavin, 16 Q. B. 48, 81.

We think it was the purpose of the statute that any distribution made to shareholders should be conclusively presumed to have been made from the most recently accumulated undivided profits or surplus and that it was intended that the corporation should not be permitted to determine to what year or period or to what fund it would allocate such distribution. Any other construction might well have led to confusion and inequalities.

Defendant-in-error contends that the statute means that, if a distribution was made on or after August 6, 1917, during the year 1917 and if the amount thus distributed was equal to or exceeded the current earnings for the year 1917, then the taxpayer-stockholder was taxable at the 1917 rate. Plaintiffs-in-error contend, on the contrary, that the statute did not refer to current earnings but to undivided profits or surplus accumulated in some year prior to 1917 and in the year wherein such undivided profits or surplus had most recently been accumulated.

An examination of sections 31 (a) and 31 (b) at once discloses that the Congress used the words "earnings or profits" six times whereas when referring to the rates applicable to the distributee it used entirely different phraseology, i. e., "most recently accumulated undivided profits or surplus" and "for the years in which such profits or surplus were accumulated."

It can not be assumed that these words were used carelessly
175 nor can the statute be approached with the presumption that the Congress intended that this phraseology should be equivalent to that which would express current earnings or profits. The time-worn observation may be indulged in that, if the Congress had intended to say "earnings or profits" as referring to current earnings, is could readily have done so by using these words so long familiar in taxing statutes. The language used in a taxing statute is always a matter of prime importance and the rule has recently again been stated in United States v. Merriam, 263 U. S. 179, 41

Sup. Ct. 69, 71, 72. In that case, Mr. Justice Sutherland, speaking for the court said:

"On behalf of the Government it is urged that taxation is a practical matter and concerns itself with the substance of the thing upon which the tax is imposed rather than with legal forms or expressions. But in statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer. Gould v. Gould, 245 U. S. 151, 153, 38 Sup. Ct. 53, 62 L. Ed., 211. The rule is stated by Lord Cairns in Partington v. Attorney General, L. R. 4 H. L. 100, 122:

"'I am not at all sure that, in a case of this kind—a fiscal case—form is not amply sufficient; because, as I understand the principle of all fiscal legislation, it is this: If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, can not bring the subject within the letter of the law, the subject is free, however
176 apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.'

"And see Eidman v. Martinez, 184 U. S. 578, 583, 22 Sup. Ct. 515, 46 L. Ed., 697."

The cases, like Bank of Commerce v. Tennessee, 161 U. S. 134, 146, and Cornell v. Coyne, 192 U. S. 418, 431, in which the doubt is resolved in favor of the Government and against the taxpayer are those in which the taxpayer claims an exemption or a privilege.

That is not this case. Here, so far as concerns, in this regard, the construction of section 31(b), plaintiffs do not ask for an exemption or privilege; on the contrary, they assert that, as matter of right under the statute, the deceased shareholder should have been taxed at other than the 1917 rate.

It is an accepted principle that for purposes of statutory construction, within certain limits, resort may be had to subsequent statutes. United States v. Field, 255 U. S. 257; Smietanka v. First Trust & Savings Bk., 257 U. S. 602; Schwab v. Doyle, 258 U. S. 529; Monroe Cider, Vinegar & Fruit Co. v. Riordan, 280 F. R. 624; Irwin v. Gavit, 2nd Circuit, C. C. A., decided Dec. 10, 1923.

Availing of this principle, the parties each seek comfort in the revenue act of 1918. Defendant urges that the omission in
177 the revenue act of 1918 of the words "undivided profits or surplus" and the use of the words "earnings or profits," as applied to accumulations clarified section 31(b) of the revenue act of 1917. We agree that there was clarification, but not of the kind

urged by defendant, unless "undivided profits or surplus," as used in the statute of 1917 meant the same thing as current earnings or profits. We realize that the definition of "surplus" and "undivided profits" may be of some importance, but the real emphasis should be upon the expression "most recently accumulated undivided profits or surplus" and to this we shall refer infra.

In section 201(b) of the revenue act of 1918, it is provided, *inter alia*, "Any distribution shall be deemed to have been made from *earnings* or *profits* unless all *earnings* and *profits* have been distributed. Any distribution made in the year 1918 * * * shall be deemed to have been made from *earnings* or *profits* accumulated since February 28, 1913." (Italics ours.)

In section 201(d) of the same act, it is provided, *inter alia*, that dividends to shareholders "shall * * * be taxed to the recipient at the rates prescribed by law for the years in which the corporation accumulated the *earnings* or *profits* from which such dividend was paid, but the dividend shall be deemed to have been paid from the *most recently accumulated earnings or profits*." (Italics ours.)

Then follows, perhaps, the most significant provision of section 201 of the act of 1918, i. e., subdivision (e), because this subdivision removes any doubt in that act as to what is meant by "accumulated earnings or profits" and lays down a new and perfectly clear method of prorating. This subdivision (e) reads as follows:

"Any distribution made during the first sixty days of any taxable year shall be deemed to have been made from earn-
178 ings or profits accumulated during preceding taxable years; but any distribution made during the remainder of the taxable year shall be deemed to have been made from earnings or profits accumulated between the close of the preceding taxable year and the date of distribution, to the extent of such earnings or profits, and if the books of the corporation do not show the amount of such earnings or profits, the earnings or profits for the accounting period within which the distribution was made shall be deemed to have been accumulated ratably during such period."

In this 1918 act it is apparent that the Congress, for reasons deemed wise, enacted a plain rule of taxation whereby it laid hold of current earnings as the basis of the tax, allocated any distribution made during the first sixty days of any taxable year to earnings or profits accumulated during preceding taxable years and, inter alia, set up a rule of proportionate distribution to cover distributions, made as in the case at bar, intermediate the end of the first sixty days of the year (approximately March 1st) and the date of distribution, to the extent of such earnings or profits, as might have been accumulated between the close of the preceding taxable year and the date of distribution. This same provision was repeated and again enacted in section 201(e) of the act of 1921.

Notwithstanding that in these two subsequent acts the Congress found it necessary not only specifically to set forth a rule of taxation

but to use different language from what it had employed in the 1917 act, defendant here is seeking to apply the provisions of section 201, particularly of subdivision (e) of the 1918 act to the facts in the case at bar upon the insistent argument that "most recently accumulated earnings or profits," as used in the 1918 act, meant precisely the same as "most recently accumulated undi-
179 vided profits or surplus," as used in the 1917 act; and defendant to press the argument has been compelled to devise somewhat elaborate tables to show the financial status of Phelps Co. at the date of distributions in September and December, 1917.

In section 201(a)(3) of the 1917 act, relating to the war excess profits tax and defining "invested capital," reference is made to "paid-in or earned surplus and undivided profits earned during the taxable year." The subject matter of this section is entirely different from that of the statute here under consideration and, if any argument is to be rested thereon, it would be that, in 1917, the legislature demonstrated its intent to exclude undivided profits contemporaneously earned, i. e., during the current taxable year.

It is a well-established rule of statutory construction that, if technical words are used in a statute in reference to a subject matter as to which they have acquired a technical meaning, they are to be taken in a technical sense. 36 Cyc. 118 and cases cited.

Coming then to the meaning of "surplus" and "accumulated surplus," it will be found that these words have been defined or interpreted on many occasions in connection with the consideration of some particular statute. Leather Manufacturers Nat. Bk. v. Treat (U. S.), 116 F. R. 774; Anderson v. Farmers' Loan & Trust Co., 241 F. R. 322; McConnell v. Allen, 120 App. Div. 548; Mutual Ben. Life Ins. Co. v. Utter, 34 N. J. Law (5 Vroom), 489, 491; People's Fire Ins. Co. v. Parker, 34 N. J. Law (5 Vroom), 479,
482; People's Fire Ins. Co. v. Parker, 35 N. J. Law (6
180 Vroom), 575, 577; Trenton Iron Co. v. Yard, 42 N. J. Law (13 Vroom), 357, 359; Goodnow v. American Writing Paper Co., 73 N. J. Eq. 692; Mills v. Britton, 29 Atl., 231, 236, 64 Conn. 4, 24 L. R. A. 536; Equitable Guarantee & Trust Co. v. Rogers, 44 Atl. 789, 793, 7 Del. Ch. 398; Hunter v. Hersperger, 54 Atl. 65, 67, 96 Md. 292; Towery v. McGaw (Ky.), 56 S. W. 727, 728.

"Surplus" has also been the subject matter of construction in cases, inter alia, involving insurance policies and decedents' estates.

Books and essays on accounting of which many are referred to by counsel define and explain in accordance with the view of the particular author the meaning of "surplus," "surplus earnings," "surplus account," and similar expressions.

Thus, it is that general definitions will be found which may be accurate for the purposes of the discussion of a particular subject matter by a court or text book writer or essayist, but which may not be applicable to some other case. The case at bar does not call for an academic discussion of accounting or bookkeeping methods nor for a comparison of definitions found in adjudicated cases.

Two simple definitions readily understood and not embarassed by any abstruse complication may be found in cases in this circuit. In Leather Manufacturer's Nat. Bk. v. Treat, 116 F. R. 774, Judge Lacombe, in discussing a provision of the war revenue act of 1898, 30 Stat., 448, affecting bankers, said, "It would seem rather that Congress used the words 'surplus' in its ordinary sense, as indicating the amount left after setting aside sufficient of the assets of a banker to meet his liabilities."

181 Judge Augustus N. Hand, in Anderson v. Farmers' Loan & Trust Co., 241 F. R. 322, speaking for this court, in referring to the words "capital, surplus, and undivided profits," used in the statute there under consideration, said that these words related "to no particular kind of property, but are expressions describing the amount of residue of the assets after the liabilities have been deducted."

For the purposes of this case, either definition supra will do.

The expression "undivided profits" is for all practical purposes of this statute synonymous with "surplus" and certainly with "accumulated surplus." It means such profits as exist and have or have not been ascertained, but, in any event, have not been distributed or otherwise used and is distinguishable from current earnings or profits.

It is matter of common knowledge and, indeed, an obvious fact that accumulated undivided profits or surplus can not be ascertained without investigation or some appropriate method of accounting or calculation. The ordinary methods of corporate accounting in this regard have been recognized by the Supreme Court. Thus, in Eisner v. Macomber, 252 U. S. 189 at 209, Mr. Justice Pitney said:

"For bookkeeping purposes, the company acknowledges a liability in form to the stockholders equivalent to the aggregate par value of their stock, evidenced by a 'capital stock account.' If profits have been made and not divided they create additional bookkeeping liabilities under the head of 'profit and loss,' 'undivided profits,' 'surplus account,' or the like";

and Mr. Justice Brandeis, in his dissenting opinion, used, in the course of his discussion, language and illustrations familiar in usual corporate accounting and bookkeeping methods.

182 A corporation does not ordinarily set up on its books in the intermediate course of a year the amount of its accumulated surplus or undivided profits. It is manifestly impracticable from month to month to take inventories or compile data to ascertain what surplus or undivided profits have been accumulated for a fraction of a current year. Accumulated surplus or undivided profits are ordinarily ascertained at the end of a given calendar or fiscal year. What are the true accumulated undivided profits or what is the true accumulated surplus is always a question of fact and, under a revenue statute, that question of fact is usually determined by the appropriate bureaus of the Treasury Department

subject to such review as may be provided by statute. A person or a corporation really does not know what are the profits of his or its business until the conclusion of some fixed period, whether it be a calendar or fiscal year. If a corporation on February 1st of any year were to distribute in dividends profits made in the January immediately preceding, it might find that all these profits would, for one reason or another, be wiped out in March of the same year. If, on the other hand, the "undivided profits or surplus" accumulated in January were not distributed, it would be a misnomer to say that on February 1st of the same year there was on hand accumulated undivided profits or surplus for the month of January. In literal language, that might be true, because the undivided profits or surplus of January would have been accumulated in the sense that they had not been distributed. In taxing statutes, however, as in most other matters regulated by law, we do not deal in abstractions; and an income tax statute usually provides for fixed periods as the measure of calculation and obligation and this is because business, large and small, is done that way and no man in active business can tell where he stands financially for a given time, whether it be a calendar year or fiscal year or some other definite period until he shall have arrived at the end of that period
183 and is then able on facts known or ascertainable to determine, with reasonable approach to accuracy, what is his financial condition.

Section 201(e) of the 1918 act recognized all this and strikingly so in respect of the first sixty days. The Congress must have realized that dividends declared during January and February would ordinarily be declared out of the accumulated undivided profits or surplus of a preceding year. The legislature also recognized that a corporation declaring a dividend in any particular year would ordinarily declare it out of the surplus or undivided profits accumulated in some previous year and, therefore, in section 201(e) created a rule of taxation based on a system of accounting and dividend distribution not common in ordinary corporate business.

In 1918, the Congress had the benefit of the experience of 1917 and, indeed, of the whole of the year 1918 (because the act of 1918 did not become law until February 24, 1919) and found it necessary to apply, in some respects, more drastic taxation requirements. Under the Act of 1917, however, the sole preferred class comprised those corporations which prior to August 6, 1917, had made distributions out of earnings or profits accrued prior to March 1, 1913. A corporation which had made its distribution on February 1, 1917, and which had earnings or profits which had accrued subsequent to March 1, 1913, was precisely in the same situation as a corporation which made its distribution on December 31, 1917, in like circumstances.

Yet, if the contention of the defendant were to prevail, it would lead to the conclusion that the Congress in 1917 meant to apply the

1917 rate to the share holder who received a dividend from the corporation making a distribution on February 1, 1917, notwithstanding that, in similar circumstances, the rates of preceding taxable years and not of the current year were applicable under section 201(e) of the act of 1918 where the corporation made its distribution on February 1, 1918.

184 Various arguments are advanced by each side as to the reason for the legislation contained in section 31(b) of the 1917 act. Plaintiffs contend, inter alia, that this legislation was intended to release to shareholders for investment in Liberty bonds and other war purposes sums which had been accumulated by the corporations prior to January 1, 1917. Defendant contends, inter alia, that, because of war needs, the conclusion is irresistible that the shareholders were to be taxed at the rates of the 1917 act which had increased greatly over those of the 1916 and 1913 acts. We can not, however, indulge in speculation as to all the reasons which actuated the Congress in enacting a particular statute. We must find solution by applying the usual relevant principles of statutory construction.

Under the act of October 3, 1913, all dividends distributed after March 1, 1913, were taxable whether the profits out of which such dividends were declared were accumulated before or after that date. Although the World War had begun and economic conditions had been disturbed, the revenue act of 1916 permitted the declarations of dividends out of surplus accumulated prior to March 1, 1913, tax free, even though profits earned subsequent to March 1, 1913, remained undistributed. This history throws some light on the controversy because, under section 31(b) of the 1917 act, while profits accumulated prior to March 1, 1913, could still be distributed tax free, that tax-free distribution could be availed of only after distribution of earnings and profits accrued since March 1, 1913, had been made.

It was in regard to this feature that the Senate committee on October 2, 1917, said in its report, submitted to the Senate after conference with the House of Representatives,

"In order to be just to the corporations and at the same time
185 to encourage them to distribute their annual earnings, your committee reported to the Senate and the Senate adopted an amendment providing that the surplus when distributed shall be taxed to the distributee at the rate prescribed by law for the year in which they were earned, but also provided that any distributions of surplus made in 1917 or subsequent tax years should be deemed to have been made from the most recently accumulated undivided profits, thereby making it necessary for the corporation to distribute its surplus earned since March 1, 1913, before that earned prior to that time." (Cong. Rec., page 8690.)

There is no suggestion in this report that "most recently accumulated surplus or undivided profits" was intended to refer to 1917. On the contrary, the observation as to encouraging corporations to

distribute "their annual earnings" indicated a clear understanding that accumulated "undivided profits or surplus" are ascertained upon some annual basis; and the committee was distinguishing between surplus accumulated before March 1, 1913, and surplus accumulated after that date.

The legislation as originally passed by the Senate read:

"Provided further, That any distribution made to the shareholders of a corporation, joint stock company, or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made *from the net income of the years in which such distribution is made or, if such income is insufficient*, from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the shareholder of the respective years in which earned by the corporation, joint stock company, or association, or insurance company, and shall be taxed to the shareholder at the rate prescribed by law for such year."

186 This had been preceded by the report made by Senator Simmons, chairman of the Senate Finance Committee, wherein it was stated, inter alia.

"Ninth, That dividends declared and paid in the year 1917, or subsequent tax years, shall be deemed to have been paid from the *net income of the year in which paid, or from the most recently accumulated surplus*, and shall constitute a part of the annual income of the shareholder for the years in which earned by the concern, and the tax to be paid by the shareholder thereon shall be at the rate prescribed by law for such years." (Report No. 103, 65th Congress, 1st session, Calendar No. 106, p. 21.)

While the Senate Finance Committee and the Senate intended that dividends declared in 1917 should be deemed to have been paid first from such net income as might be earned in 1917, it is plain that this program was not satisfactory to the Conference Committee. The result was that the part of the bill italicized supra, as passed by the Senate, was stricken out and 31(b) was enacted in its present form.

It is argued by defendant that the reason for this elision was that the technical meaning of "net income," under an income tax statute, is by no means synonymous with net earnings because a taxpayer is allowed certain exemptions and the like before his net income can be ascertained.

We think this argument is not convincing; for before the net income of a year can be determined the net earnings must first be ascertained. The real point of this legislative history is that the legislature was not, in this regard, dealing with current earnings and, by the most obvious procedure, had eliminated current earnings from consideration as affecting the rate at which the taxpayer was to be taxed.

187 Of all the other contentions we notice but one. The illustration is suggested of a corporation which had no surplus on

December 31, 1916, or prior thereto and which made earnings, large or small, during the year 1917, and the question is asked whether such earnings would go tax free. Experience demonstrates that, however carefully, a tax statute rarely, if ever, can be drawn with such extraordinary foresight that it will provide for every possibility. Two answers may be suggested to the inquiry: First, if the 1917 statute had continued on the books, any undivided profits or surplus accumulated in 1917 could have been reached in 1918; second, just as shareholders of those corporations which made a distribution prior to August 6, 1917, were in some respects preferentially treated, so it might be well contended that the shareholders in those corporations which might distribute subsequent to August 6, 1917, out of undivided profits or surplus accumulated prior to 1917 were to be preferentially treated over those who received dividends out of profits made solely in 1917. There is support for the latter view in conditions that were then and are now well known. The war appreciated the value of certain classes of business and destroyed or impaired the value of others. New business enterprises were started to manufacture and sell munitions and other products to which the war had given unprecedented values. It was but right that those who benefited should make substantial contributions to the Government. Upon the other hand, many corporations, at the close of 1916, had on hand accumulated surplus or undivided profits which had not been distributed. The shareholders of such corporations had, in effect, no power to compel distribution; for, in the absence of fraud, declaration of dividends and the distribution of accumulated surplus and profits rested in the discretion of the directors of the corporations.

188 It may well be concluded, as indicated by the report of the Senate committee, after conference, that it was regarded as fair that the shareholder, who had invested his money in a corporation which on December 31, 1916, or prior thereto, had accumulated undivided profits or surplus undistributed, should not be asked to pay the high 1917 rate, if dividends could be distributed out of previously accumulated undivided profits or surplus. But, if any or all these suggestions are without merit, it is nevertheless clear, as matter of statutory construction, that it was not intended, on facts such as those in the case at bar, that the shareholder should be taxed at the 1917 rate, even though, because of the amount involved, "it requires a struggle to resist the influence of the fact," as was tersely said by Mr. Justice McKenna, in Lynch v. Turrish, supra.

We have not overlooked the Treasury regulation (article 107 of Regulations 33, revised), which interpreted the statute substantially as defendant contends. We are also mindful of the rule that the regulations and practices of administrative departments are entitled to weight and serious consideration in construing a statute; but opposed to this rule is the familiar one that it is for the courts to construe a statute and not the executive departments of the Govern-

ment and, where, as here, we are satisfied that the statute requires the construction which we have attributed to it, a Treasury regulation rises to no higher dignity than an expression of opinion.

We have also not overlooked the fact that Douglas paid at the 1917 rates on the so-called regular dividends, but, as this payment was not in issue in this litigation, we express no opinion as to what might be the correct rule if Douglas had insisted that his so-called regular dividends were not subject to the 1917 rate.

We have also noted the observation passim of counsel for defendant that the complaint stresses the proposition that the
189 so-called depletion dividends were capital and not income and that it is not, in so many words, alleged that Douglas is not subject to the 1917 rate. We think, however, that the language, both of the protest and of the complaint, is sufficiently broad to put the question in issue and the record clearly indicates that the parties litigated this question as well as the capital-income question and so desired and understood.

In view of our conclusion that the so-called depletion dividends were taxable, there was on hand on December 31, 1916, a sum amply sufficient to enable Phelps Co. to pay these dividends out of the accumulated surplus or undivided profits as of December 31, 1916; and these dividends distributed to and received by Douglas should have been taxed at the rate prevailing in 1916.

Under Slocum v. New York Life Insurance Co., 228 U. S. 364, we must reverse the judgment below, but the District Court is directed on a new trial to enter judgment in accordance with this opinion.

Judgment reversed.

190–191 In United States Circuit Court of Appeals

[Title omitted.]

Judgment

April 14, 1924

Error to the District Court of the United States for the Southern District of New York.

This cause came on to be heard on the transcript of record from the District Court of the United States, for the Southern District of New York, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed.

It is further ordered that a mandate issue to the said District Court in accordance with this decree.

H. W. R.

M. T. M.

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192 In United States Circuit Court of Appeals

Clerk's certificate

I, William Parkin, clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 191, inclusive, contain a true and complete transcript of the record and proceedings had in said court, in the case of Archibald Douglas, et al., as executors, etc., plaintiffs in error, against William H. Edwards, as collector, etc., defendant in error, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said court to be hereunto affixed, at the city of New York, in the Southern District of New York, in the Second Circuit, this 27th day of June, in the year of our Lord one thousand nine hundred and twenty-four and of the independence of the said United States the one hundred and forty-eighth.

[SEAL.] WM. PARKIN, *Clerk.*

193 In Supreme Court of the United States

Order granting petition for certiorari

Filed Oct. 20, 1924

On petition for writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

On consideration of the petition for a writ of certiorari herein to the United States Circuit Court of Appeals for the Second Circuit, and of the argument of counsel thereupon had, it is now here ordered by this court that the said petition be, and the same is hereby, granted, the record already on file as an exhibit to the petition to stand as a return to the writ.

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In the Supreme Court of the United States

OCTOBER TERM, 1924

WILLIAM H. EDWARDS, COLLECTOR OF Internal Revenue, Petitioner
v.
ARCHIBALD DOUGLAS, GEORGE NOTMAN, and Edmund Coffin, as Executors of the Estate of James Douglas, deceased, Respondents } No. —

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF

The Solicitor General on behalf of William H. Edwards, Collector of United States Internal Revenue for the Second District of the State of New York, prays that a writ of certiorari may issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit reversing a judgment heretofore rendered by the United States District Court for the Southern District of New York in favor of the petitioner and against the respondents.

STATEMENT OF THE CASE

This action was brought by respondents to recover the sum of $173,579.72, the amount of an additional

tax assessed on the income of their testator for the year 1917, and paid by them under protest to petitioner. The additional tax was assessed in respect to two distributions aggregating $328,400, made to Dr. Douglas in the year 1917 by Phelps Dodge Corporation, a mining corporation, in which he was a stockholder. It was stated in the resolutions declaring these distributions that the same were to be paid from the depletion reserve set up on the books of the corporation to make good the exhaustion of its mines caused by the extraction of the ores. It was claimed by Dr. Douglas in his income-tax return, and by respondents in their complaint, that for this reason these distributions were returns of capital and could not be taxed as income under the Sixteenth Amendment. The Commissioner of Internal Revenue rejected this claim because at the time of making these distributions Phelps Dodge Corporation had on hand a surplus greatly in excess of the amount of such distributions. He therefore treated them as income to the taxpayer, and since the corporation had for the year 1917 earnings sufficient to cover these, and all other, distributions made in that year, assessed a tax thereon at the rates prescribed by law for the year 1917.

Upon the trial of this action in the District Court respondents, while insisting that the aforesaid distributions were returns of capital and not income, made the further claim that if the same should be held to be income and taxable under the Revenue Act of 1917, by the provisions of Section 31 (b) of

that Act they are not taxable at 1917 rates. The District Court held that these distributions were income to Dr. Douglas and taxable at 1917 rates and dismissed the complaint upon the merits. Respondents sued out a writ of error and the Circuit Court of Appeals for the Second Circuit reversed the judgment, holding that the distributions were not returns of capital but were income and taxable as such, but that under Section 31 (b) of the Revenue Act of 1917 they were deemed to be paid from the surplus accumulated in the year 1916, and should be taxed at the much lower rates prescribed for that year. The basis of the decision is that "the most recently accumulated undivided profits or surplus," from which by the provisions of that section all distributions in the year 1917 are deemed to be made, does not include the current earnings for that year, but refers only to the surplus or undivided profits account of the corporation at the close of the last fiscal period.

THE QUESTION PRESENTED

Under section 31 (b) of the revenue act of 1917 are distributions made by a corporation to its shareholders in the year 1917 taxable to the shareholders at the rates prescribed by law for the year 1917, if the corporation has earnings for that year sufficient to pay them, or must they be allocated to the surplus accumulated in prior years and bear the lower rates of taxation prescribed for prior years?

REASONS FOR THE ISSUANCE OF THE WRIT

1. The question presented is of vital importance to the Government and to the public, not only because

of the large amount involved in this suit, and in other suits by stockholders of the same corporations involving the same distributions, but because of the large amounts of refunds that must be made to taxpayers generally if the decision of the Circuit Court of Appeals is to be accepted as final. The decision does not turn on any point peculiar to this case, but is of general application to all distributions made by a corporation to its stockholders in the year 1917. The Bureau of Internal Revenue has consistently ruled that all distributions made in 1917 are taxable at 1917 rates to the extent that the earnings of the corporation for that year are sufficient to cover the same. In the year 1917 vast distributions were made by many corporations to their stockholders from profits made from war activities. If all distributions in 1917 which have been taxed at 1917 rates are to be taxed at the much lower rates prescribed for the year 1916 or previous years, or are not to be taxed at all, the amount to be refunded, even allowing for the running of the five-year period of limitations on 1917 claims for refund, will be enormous and may seriously affect the fiscal policy of the Government.

2. A very large number of cases involving the question presented in this case are now pending in District Courts throughout the country and before the Treasury Department. Many such cases are being held dormant pending the final decision of this case. Decision by this court is necessary to

prescribe a uniform rule by which all such cases can be disposed of. It is of the utmost public importance that the business of the courts and of the Treasury Department should not be impeded by cases which can be settled by a final determination of this question in this case. By such a determination useless litigation at great expense to the taxpayer and the Government will be avoided.

3. The Circuit Court of Appeals has erroneously construed Section 31 (b) of the Revenue Act of 1917. As shown in the brief submitted herewith, the construction placed upon this section by the Circuit Court of Appeals is contrary to the plain intention of Congress, distorts the literal and commonly accepted meaning of the words used, leads to unjust and absurd results, and disregards the contemporaneous and long-continued construction of this section by the Treasury Department in which the taxpayer and the corporation here involved acquiesced.

Wherefore, it is respectfully asked that a writ of certiorari may issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit.

JAMES W. BECK,
Solicitor General.

BRIEF IN SUPPORT OF PETITION

Section of the statute involved

Section 31 (b) of the Revenue Act of 1916, added by Section 1211 of the Revenue Act of 1917 (Act of October 3, 1917, 40 Stat. 300), provides in part as follows:

> Any distribution made to the shareholders * * * of a corporation * * * in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation * * *, but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed * * *, exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made. This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen.

ARGUMENT

The Circuit Court of Appeals has held that "the most recently accumulated undivided profits or surplus" from which distributions by a corporation in 1917 are deemed to have been made is limited to such undivided profits and surplus as have been definitely ascertained by a closing of the books and does not include current earnings on hand at the time of the distribution.

The meaning of this section is made clear by a consideration of the circumstances attending its enactment. This section became law as part of the Revenue Act of 1917, the first revenue statute enacted by Congress after the entry of the United States into the World War. By this statute the rates of income tax were greatly increased over the rates prescribed by the Revenue Act of 1916, a heavy excess-profits tax was enacted, and many new and increased taxes were imposed. The purpose of this increased taxation was to enable the Government to defray the heavy expenses incident to the war. At the same time business was disturbed. New war industries sprang into being, and established concerns, the products of which were not essential to the prosecution of the war, were unable to operate at a profit, and were forced to draw upon the surplus accumulated in prior years in order to pay dividends.

In the income tax acts passed prior to the Revenue Act of 1917 dividends were subject to taxation at the rates prescribed for the year in which they were paid, the only exception being that under the Reve-

nue Act of 1916 dividends declared by a corporation out of its surplus accumulated prior to March 1, 1913, were held to be exempt from tax. The bill as it passed the House of Representatives taxed all dividends at 1917 rates, except dividends declared from March 1, 1913, surplus. In the Senate, however, the case of a stockholder receiving dividends from a corporation, which, owing to war conditions, was not operating at a profit, but was drawing upon its surplus accumulated in prior years, was considered, and it was deemed inequitable to tax him at the high 1917 rates on dividends paid from surplus accumulated when the tax rate was low. The result was the rules of allocation contained in Section 31 (b).

The plain meaning of this section is that distributions to stockholders are to be regarded as having been made from the most recent earnings of the corporation and are to bear the tax rate prescribed for the year in which such earnings accrued. The Circuit Court of Appeals correctly holds that the word "deemed" creates a conclusive presumption which can not be set aside by any declaration of the corporation that the distribution is made from some other fund. So construed this section lays down a rule of taxation which has regard both to the necessities of the Government and the equities of the taxpayer, namely, that distributions made in 1917 shall first be applied to 1917 earnings and taxed at 1917 rates, so far as such earnings are sufficient to cover the same, and any excess of distributions over earn-

ings shall be applied to any undistributed earnings of 1916, and taxed at 1916 rates, and so on, until all earnings accumulated since March 1, 1913, have been distributed, when tax-free distributions of earnings accumulated prior to that date may be made.

This construction is in accordance with the literal and commonly accepted meaning of the words "surplus" and "undivided profits".

Surplus is commonly used to denote excess of assets over and above liabilities and capital. This definition may be found in dictionaries, works on accounting, and court decisions. It is even adopted by the Circuit Court of Appeals in its decision. If this definition is correct the surplus at any given time is the excess of assets over liabilities and capital as it exists at that time, and the most recently accumulated surplus is the excess most recently acquired, namely, the most recent current earnings, whether or not there has been a balancing of the books and a closing into a surplus account. Clearer still is the term "undivided profits." The Circuit Court of Appeals in its opinion thus defines "undivided profits":

> It means such profits as exist and have or have not been ascertained, but, in any event, have not been distributed or otherwise used * * *.

Such profits as exist and have or have not been ascertained and have not been distributed is the exact description of current earnings to which it is petitioner's contention that all distributions in 1917 must first be allocated. The term "undivided

profits" is used in Section 207 of the same Act to mean current profits, which are excluded from invested capital under the phrase "undivided profits earned during the taxable year."

To construe "the most recently accumulated undivided profits and surplus" as "the most recently accumulated undivided profits and surplus *account*" of the corporation is to extend the liberal meaning of the words, and it has been recently said by this court:

> But in statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used. *United States* v. *Merriam*, 263 U. S. 179.

Literally, therefore, "the most recently accumulated undivided profits or surplus" are the most recent current earnings, and unless this construction is adopted all of the provisions of this section cannot be construed consistently with each other. In the last clause of this section it is provided that earnings and profits accrued prior to March 1, 1913, may be distributed exempt from the tax only after distribution of all earnings and profits accrued since that date has been made. This is an absolute rule of law prohibiting a tax free distribution of earnings accrued prior to March 1, 1913, until all subsequent earnings and profits, including current earnings and profits, have been distributed. If a corporation in 1917 has on hand a surplus accumulated prior to March 1,

1913, and a large amount of current earnings, which it distributes to its stockholders, every distribution which it makes is conclusively presumed to have been made from the most recently accumulated surplus, which by hypothesis under the construction of the Circuit Court of Appeals is the March 1, 1913, surplus. Since there was no tax in force at that time by the first clause of Section 31 (b) such a distribution would be tax free. By the last clause, however, no tax free distribution can be made of March 1, 1913, surplus until all current earnings have been distributed. At what rate then shall such a distribution be taxed? This question cannot be answered under the construction adopted by the Circuit Court of Appeals.

Furthermore, if a corporation had a deficit at the beginning of 1917 or if it was not organized until that year, and made large profits which it distributed to its stockholders, are these distributions tax free or are they taxable at 1917 rates? This was a very common case and could not have been overlooked by Congress. If the answer is that such distributions are taxable at 1917 rates, then "the most recently accumulated undivided profits or surplus" does include current earnings, as petitioner contends, and the construction of the Circuit Court of Appeals is erroneous. If the answer is that they are tax free, because there is no undivided profits or surplus account to which they can be allocated, the conclusion is absurd, since Congress can not have intended to exempt an individual from taxation on distributions

received in 1917 because of the previous financial condition of the corporation making the same.

It is also apparent that under this construction the tax rate of individuals depends upon when and how often the corporation closes its books. One who is so unfortunate as to be a stockholder in a corporation which has a fiscal year ending in the middle of the year and pays its dividends in the latter part of the year may find the greater part of his distributions taxed at 1917 rates, whereas another who is a stockholder in a corporation on a calendar year basis would pay a tax at the much lower 1916 rates. Stockholders in corporations closing their books monthly, quarterly, or semiannually would pay taxes at 1917 rates on a large part of their distributions, whereas stockholders in corporations closing their books annually on a calendar year basis, but making the same earnings, would pay at most only the 1916 rates. The rate of taxation of individuals is made to depend upon the bookkeeping methods of corporations in which they are stockholders instead of upon the facts, which is unequal and unjust.

This construction also leads necessarily to the conclusion that Congress intended to discriminate in favor of income derived from dividends and against income derived from interest, rent, and personal efforts. No reason has ever been advanced for such a discrimination. With the exigencies of the war requiring the tapping of every available source of revenue, and with the abnormal war profits coming to individuals largely through dividends from cor-

porations making such profits, it is unreasonable to suppose that Congress would have provided that dividends should in most cases be taxed at a much lower rate. Certainly a discrimination so unjust and so baseless should not be imputed to Congress if a more reasonable interpretation of the statute is possible.

> We are therefore bound to give heed to the rule, that where a particular construction of a statute will occasion great inconvenience or produce inequality and injustice, that view is to be avoided if another and more reasonable interpretation is present in the statute. *Knowlton* v. *Moore*, 178 U. S. 41, at page 77.

The Circuit Court of Appeals relies strongly upon the fact that corporations which must take extensive inventories and close their books annually can not know at any intermediate time what, if any, profits have been made. It is not perceived how this has any bearing on the construction of Section 31 (b). By trial balance or otherwise directors can ascertain with reasonable certainty at any time what profits have been made, and ultimately the time will come when the profits will be exactly determined and it can be known with certainty whether they are sufficient to cover the distributions for the year. Dividends are commonly gauged by, and paid out of, current earnings even by corporations of this nature. Furthermore, this section is of general application, and most corporations are able to tell exactly what are their earnings and profits for the year at any time. It is generalizing the particular to make the

accounting methods of a few of the larger and wealthier corporations determine the construction of this section.

Lastly, it may be pointed out that the construction of this section by the Treasury Department was adopted by the very corporation and taxpayer involved in this case. Phelps Dodge Corporation in its annual statement to stockholders stated that all of its dividends, except one in March, which was said to be from 1916 earnings, and the so-called depletion distributions were paid from 1917 earnings, and Dr. Douglas so reported them in his income tax return for that year. This construction was first promulgated by the Treasury Department in Article 107 of Regulations 33 Revised, issued in January, 1918, and there has never been any ruling or practice inconsistent therewith. It was approved simultaneously, but independently, by the District Court in the case at bar and by the United States District Court for the Northern District of New York in the case of *Harder* v. *Irwin*, 285 Fed. 402. It is the only construction which is consistent with the words used and the plain intention of Congress, and the only one under which inconsistent, unjust, and absurd results can be avoided.

Wherefore, it is respectfully submitted that a writ of certiorari should issue to review the judgment of the Circuit Court of Appeals for the Second Circuit to the end that said judgment may be reversed and the judgment of the District Court be reinstated.

JAMES M. BECK,
Solicitor General.

JULY, 1924.

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